

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

IN RE: CITY OF DETROIT, . Docket No. 13-53846
MICHIGAN, .
 . Detroit, Michigan
 . September 17, 2014
Debtor. . 8:32 a.m.

TRIAL RE. OBJECTIONS TO CONFIRMATION OF CHAPTER 9 PLAN
BEFORE THE HONORABLE STEVEN W. RHODES
UNITED STATES BANKRUPTCY COURT JUDGE

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1 THE COURT: All right. Let's resume with our trial,
2 please.

3 MR. CULLEN: Good morning, your Honor. Thomas
4 Cullen of Jones Day for the city. I thought I'd inform the
5 Court of the current order in light of developments
6 yesterday, and this is what we have in mind for the order
7 going forward to the end of Thursday.

8 THE COURT: Okay. Thank you, sir.

9 MR. BARNOWSKI: Good morning, your Honor. Dan
10 Barnowski, Dentons, on behalf of the Official Committee of
11 Retirees. The committee calls now Ron Bloom.

12 THE COURT: Okay. Step forward please, sir. Please
13 raise your right hand.

14 RON BLOOM, RETIREE COMMITTEE'S WITNESS, SWORN

15 THE COURT: Please sit down.

16 DIRECT EXAMINATION

17 BY MR. BARNOWSKI:

18 Q Good morning, Mr. Bloom.

19 A Good morning.

20 Q Could you introduce yourself to the Court?

21 A My name is Ron Bloom.

22 Q One background issue, Mr. Bloom, the microphone. You
23 might have to lean it forward to make sure that everyone can
24 hear you.

25 A Okay.

1 Q Who do you work for, Mr. Bloom?

2 A I work for an investment bank in New York City called
3 Lazard Freres.

4 Q And how long have you been with Lazard?

5 A About two years.

6 Q Can you give us just a brief overview of the type of work
7 that Lazard does?

8 A Lazard is a financial advisory firm, so we give advice to
9 companies and other enterprises. You know, significantly, in
10 the mergers and acquisitions field, one company might want to
11 buy or sell another company. We also have a very active what
12 we call a restructuring practice where we're advising either
13 creditors or debtors in either Chapter -- in chapter
14 proceedings or out-of-court restructurings.

15 Q Okay. And do you have a formal title at Lazard?

16 A I'm a vice chairman.

17 Q Has Lazard played a formal role in this bankruptcy?

18 A Yes, we have.

19 Q Tell the Court what that is.

20 A We were retained by the Retiree Committee in September of
21 last year and have served as their financial advisor
22 throughout that period.

23 Q And what are Lazard's responsibilities with respect to
24 the committee just generally?

25 A Generally speaking, as the financial advisor, our

1 responsibility has been to try to analyze the city's
2 financial circumstance, to give advice to the committee about
3 what the economics of the city are, and then to look --
4 specifically in the negotiations regarding the pension matter
5 and the OPEB matter, to look at creative ways to solve the --
6 you know, the significant problems that the city faced, and
7 then to bring to bear our general experience in restructuring
8 to help the committee navigate through the complex multi-
9 stakeholder dimension of this matter.

10 Q Okay. And without getting into the details of them, have
11 you been involved in negotiations with the city on behalf of
12 the committee?

13 A Yes.

14 Q And who leads the retention on behalf of Lazard?

15 A I do.

16 Q Before we dig into those areas a little bit, I'd like to
17 talk to you a little bit about your background. Where did
18 you go to college?

19 A I went to college at a university in Connecticut called
20 Wesleyan University.

21 Q Okay. And where did you go to work after you graduated
22 Wesleyan?

23 A Shortly after graduating from Wesleyan, I became employed
24 by the Service Employees International Union in Boston,
25 served as what we called at the time -- the title was

1 research and negotiating specialist. The Service Employees
2 at that time had significant representation in the public
3 sector, a little bit in the healthcare, and a little bit in
4 the building service sector but principally in the public
5 sector in and around the Boston area, broader New England
6 actually, in and around that area, and I served as both doing
7 research trying to, again, ferret out the facts of
8 circumstances as well as helping in particular collective
9 bargaining opportunities.

10 Q And how long did you work there?

11 A I was there about five years.

12 Q And then you went to business school; is that right?

13 A Yes, I did.

14 Q Where did you go to business school?

15 A I went to business school at Harvard.

16 Q Why did you -- why did you decide to go to business
17 school?

18 A Well, I'd been working for the SEIU, and my observation
19 had been that unions oftentimes were not equipped with the
20 business skills, the financial skills that would be required
21 to have kind of a constructive intelligent dialogue with
22 employers, and I found the idea of better understanding
23 business and how business is operated to be personally
24 interesting. There were a lot of great union side labor
25 lawyers around, and so I chose a slightly different path,

1 thought I would have a sort of unique value add on the basis
2 of gaining those skills.

3 Q Okay. And after you obtained your MBA, where did you go
4 work?

5 A After I got my MBA, I went to work actually at Lazard
6 Freres in New York City.

7 Q Okay. And you worked at Lazard for how long?

8 A I was there for about five years. I was an associate and
9 then a vice president, again, principally involved in both
10 mergers, acquisitions, and restructurings.

11 Q And you left Lazard to open your own investment bank; is
12 that correct?

13 A Yes. Myself and another gentleman who, at the time, was
14 a partner of the firm, fellow named Gene Keilin and I in 1990
15 formed a firm that we called Keilin & Bloom, and our business
16 was advising mostly unions, employee groups, in -- largely in
17 restructuring situations, so sort of a continuation of some
18 of what I'd been doing at Lazard but with more of a focus
19 just on union clients.

20 Q What was your next job?

21 A So I did that for about five years, and when I was there
22 and actually dating back to my period at Lazard, the
23 steelworkers union was one of our largest clients. There
24 were a lot of restructurings in the steel industry in the
25 late '80s and mid-'90s. I worked for other unions as well,

1 but the steelworkers were the single largest client, and I
2 decided to go to work directly for the steelworkers union in
3 Pittsburgh, Pennsylvania, in 1996.

4 Q What was your title with the steelworkers?

5 A I was a special assistant to the president.

6 Q And what kind of work did you do?

7 A In some ways it was a continuation of what I had been
8 doing, giving the union advice in restructurings in complex
9 situations. I took on a bit broader responsibility as well.
10 The steelworkers union is a very diverse industrial union
11 mostly in what would be called primary manufacturing, so
12 steel, tires, and plastic, aluminum, paper, those sorts of
13 sectors. And in each of those sectors, the union has kind of
14 a collective bargaining program where it's attempting to do
15 the best for its members in those different sectors. And my
16 responsibility was to provide broad oversight and
17 coordination to the unions' efforts in those primary
18 entities, in those big larger companies. The union has many
19 contracts with smaller companies, but for the 15 or 20 large
20 companies who would represent a significant percentage of the
21 steelworker membership and would, in union parlance, set the
22 pattern for other bargaining circumstances, my responsibility
23 was to try to help coordinate and bring structure to those
24 sorts of situations. In addition, again, similar to what had
25 been happening in the '80s and '90s before I got there, there

1 was a lot of restructuring in all of those industries. These
2 were old line manufacturing industries they felt faced
3 pressure from imports. They face pressure from what are
4 called legacy costs. So I found myself involved again in a
5 significant amount of restructuring work for the steelworkers
6 union.

7 Q You mentioned the steelworkers membership. Tell the
8 Court roughly how many members there were at the time.

9 A During the time I was there, I would say roughly 1.2
10 million active and retired members, maybe six or 700,000
11 active, depending on the time exactly, and maybe five or
12 600,000 retirees who the union was trying to look after.

13 Q You left the steelworkers when?

14 A In early 2009.

15 Q Why?

16 A Well, as everyone I'm sure remembers, in 2008 the great
17 recession began, and one of the signal events of it for me
18 anyway was the collapse of General Motors and Chrysler. I
19 had never had any direct dealings with the automobile
20 companies. I'd had deals with parts suppliers. But if
21 you're in the manufacturing sector, in some ways the auto --
22 an auto company kind of sits at the top of the pyramid, so if
23 you think about what's in a car, it's just about everything
24 that's made, you know, and so whether it's steel or whether
25 it's plastic or whether it's rubber or chemicals, everything

1 kind of goes into a car. And so a company like GM or
2 Chrysler, GM obviously larger than Chrysler, but a company
3 like GM really, as I said, sort of sits at the pyramid of the
4 entire manufacturing economy. In late 2008, General Motors
5 collapsed. They were literally on the verge of extinction.
6 If the Bush administration had not provided the emergency
7 assistance, I believe the company would have literally
8 liquidated, and the ramifications of that for the
9 manufacturing economy more broadly were just -- to my way of
10 thinking, just dramatic and, candidly, kind of unthinkable.
11 And so given my background and given what I'd been doing for
12 the prior 25 years, I said to my wife -- I said, "I've been
13 in training for this job my whole life. I really want to try
14 to be part of this. I want to see if I can help." There'd
15 been a, you know, new president elected, and it was clear
16 from the way that the Bush administration structured the loan
17 that the Obama administration was going to be responsible for
18 resolving this problem, and so I found a way into the Obama
19 administration to work on the President's auto task force and
20 help lead that effort.

21 Q Okay. And how long did you stay with the -- well,
22 technically, you were -- what was your title?

23 A I was a senior advisor to the Secretary of the Treasury.

24 Q Okay. And how many restructurings did you work on in
25 that position?

1 A Well, they were -- GM and Chrysler was really the
2 exclusive focus of our work.

3 Q Okay.

4 A That's not quite right. We also worked a bit on Delphi,
5 but Delphi was GM-related. But it was about the car industry
6 generally, but the focus was GM and Chrysler.

7 Q And tell the Court generally the number of actives and
8 retirees who were tied up in those restructurings.

9 A Well, I think by memory I would say that at the time of
10 the GM failure, in terms of blue collar workers, GM probably
11 had roughly 50 or 60,000 UAW members -- that's the union that
12 represents the blue collar workers -- and probably on the
13 order of 500,000 retirees. That's on the blue collar side.
14 In Chrysler there were probably roughly 30,000 active UAW
15 members and probably 150 to 200,000 retirees, so rather
16 dramatic numbers of retirees and a rather dramatic ratio of
17 retirees to actives.

18 Q Is it fair then to conclude that there was a
19 disproportionate number or amount of legacy costs involved in
20 these restructurings?

21 A Clearly one of the very significant issues facing the car
22 companies and, candidly, facing a number of situations I've
23 been in -- and this was one of the reasons why I sought the
24 assignment is that this is a -- this is a matter that I had
25 dealt with before where because an old line company either

1 shrinks, its market share goes down, or there's significant
2 productivity enhancement, you wind up with a very small
3 number of actives per retiree, and that kind of ratio,
4 because in these companies, generally speaking, there were
5 promises made to provide pensions, healthcare to folks after
6 they retired, those promises became a very significant
7 obligation and liability of the company, and in otherwise
8 challenging economic times -- there were many issues facing
9 GM, but among those issues -- and Chrysler, but among those
10 issues was the company's very significant legacy cost. And
11 as I said, that's an issue -- that's a movie I'd seen, I'd
12 kind of been in a lot over my prior career, and so I was very
13 eager to try to work on it.

14 Q And those restructurings were fairly quick. Is that
15 fair?

16 A Yes. General Motors was in and out of bankruptcy in 39
17 days. Chrysler was in and out of bankruptcy in 42 days.

18 Q So what did you do after the 42 days were up?

19 A Well, there was a bit of run-up to it, so there was that.
20 And then the bankruptcies occurred, and then most of the
21 team -- we essentially assembled what you might call a deal
22 team of people who'd not prior been in government who kind of
23 came down to work on the case and worked in the Treasury
24 Department. I decided to stay on. The government had
25 invested, you know, close to \$50 billion in these companies,

1 and so there was a lot of interest in making sure that
2 investment was going okay and the companies were being
3 responsible with the money. The government was not directly
4 involved in the day-to-day oversight or management of the
5 company, but, nevertheless, with an investment of that size,
6 there was a keen interest on the part of the administration
7 and the government generally in what was going on, so at that
8 stage a number of the other members of the task force had
9 left, and so I was asked to lead up the remaining effort,
10 which was to monitor the two investments.

11 Q Okay. And did you subsequently move to a different
12 position within the administration?

13 A Yeah. So I did that for another six or eight months,
14 maybe nine months, and then at that -- by that point -- it
15 was closer to a year. I apologize. At that point, General
16 Motors -- we were successful, and I was responsible at the
17 Treasury Department for leading the Treasury Department's
18 effort in the initial public offering of GM, and so we'd been
19 able in a relatively short period of time, 17 months, to
20 return General Motors to the public markets. Chrysler had --
21 was on its way to a recovery despite many people feeling that
22 wouldn't happen, and there was pretty good visibility to the
23 government getting its money back for Chrysler. And so after
24 the GM IPO and after we had visibility at Chrysler to the
25 government being able to exit its Chrysler investment, I felt

1 like there was not, you know, tremendous amounts still to do.
2 While the government still had investment in GM, there was
3 now a public market. It was pretty clear what was going to
4 happen, a gradual sell-down, and so at that stage I decided
5 to -- and was offered an opportunity to move over to the
6 White House where I served as an assistant to the President
7 for manufacturing policy.

8 Q Okay. One more question about GM and Chrysler. What was
9 the ratio of retirees to actives at those two companies?

10 A Well, as I said, in the case of the blue collar, probably
11 roughly ten to one in the case of GM and maybe six or eight
12 to one in the case of Chrysler, very, very significant.

13 Q Now, in 2012 you went back to Lazard; is that right?

14 A Yeah. I took a little bit of time off. I'd been
15 commuting to Washington from my home in Pittsburgh, and so I
16 had some family business to attend to, but, yes, shortly
17 thereafter I went -- I came back to Lazard after a 20-odd-
18 year hiatus.

19 Q Okay. So let's talk about the work that Lazard has done
20 on behalf of the Official Committee.

21 A Okay.

22 Q First of all, can you describe just generally the nature
23 of the committee's relationship with the city in this case?

24 A Well, you know, we viewed ourselves as representing by
25 far and away the largest creditor interest, the pension and

1 retiree healthcare, roughly -- depending on how one scores
2 it, roughly 80 percent of the claim amount -- of the total
3 unsecured claim amount in the city, so we viewed ourself as a
4 very significant stakeholder in the case, in the matter, an
5 important creditor. And we believe that we had, you know,
6 very valid and important claims relative to our claims. I
7 think, in general, our relationship with the city was, you
8 know, professional. The city had serious professionals on
9 their side. I hope we had the same on ours. But, you know,
10 we had a pretty different view of how the case should go.
11 The city had put forward a plan -- not a plan but sort of an
12 indication of where they saw things going in June before they
13 filed. That approach, that plan with a small "P" was not
14 something we thought was remotely fair to the retirees, and
15 so we had a -- you know, a pretty vigorous disagreement with
16 how we thought the case should go. We took the position the
17 city didn't belong in the Bankruptcy Court at all. We took
18 the position that the pensions were constitutionally
19 protected. We took the position that when the city tried to
20 implement the 214 changes for the retiree healthcare that
21 that was inappropriate and not consistent with law, so, you
22 know, I think we always -- at least we tried to be
23 professional and direct, but we had a pretty serious
24 disagreement, at least from where the city started and where
25 we started compared to the starting points of both of the

1 parties.

2 Q As someone who was involved in the negotiations, did you
3 ever conclude that the city was treating the retirees or the
4 committee like favored insiders?

5 A Not in the least; not in the least. We felt like we had
6 very significant claims here, legal and political. As I
7 said, we felt we were 80 percent of the claim amount, and
8 that justified a significant attention to our concerns. As I
9 said earlier, we felt we had very strong legal arguments as
10 to the protection of our position. We obviously had been
11 ruled against that, but we were appealing it. And, no, we
12 felt like we got -- you know, we got the best we could get,
13 but in no sense did we view that as favoritism.

14 Q Okay. Did the committee treat the negotiation of the
15 OPEB and the pension benefits as part of the same global
16 negotiation?

17 A Yes. The Retiree Committee viewed as its charge both of
18 those obligations for inactive employees. And while there's
19 not a perfect overlap between the retiree insurance claim and
20 the pension claim in terms of the people -- there are a few
21 people who have a retiree insurance program and don't have a
22 pension and vice versa -- the overwhelming majority is the
23 same human beings -- and, again, it's not a perfect match,
24 but the overwhelming majority is the same people, and so from
25 our perspective, this was one set of promises. The city had

1 promised people pension and it had promised people
2 healthcare. Those were two promises that, in our view, were
3 important promises, and so we always viewed our job as trying
4 to represent and advocate on behalf of both of those
5 promises.

6 Q Okay. And how did that play out in terms of -- I don't
7 want you to talk about discussions with the city or
8 mediation, but in terms of the negotiations, was the
9 committee willing to give a little on one side in order to
10 get more on the other, or --

11 A Early in the case -- early in the case, the committee
12 determined that pensions would be a priority, and I think
13 there were a number of different reasons for that, but, in
14 any event, the committee concluded that there were other
15 options, at least to a degree, on the healthcare. And while
16 changes in retiree healthcare would be very painful for
17 people, the committee determined perhaps because we believed
18 we had a better legal argument on the pension, perhaps
19 because of people's emotional connection to their pension,
20 for a constellation of reasons, the committee strongly
21 believed that the priority should be on pensions. And so as
22 we approached the situation, that's what we did on behalf of
23 the committee, and the committee, as it advocated for itself,
24 determined that its highest priority was protecting the
25 pension. And, again, our initial position was the pension

1 should remain untouched in its entirety, but pretty early on
2 we signaled that we could see a compromise in the OPEB, in
3 the retiree insurance arena.

4 MR. WAGNER: Your Honor, just note my objection. To
5 the extent the testimony is being offered as the witness'
6 subjective views concerning OPEB and pension, I believe
7 that's not relevant with respect to the reasonableness of any
8 settlement, and also to the extent that OPEB and pension are
9 being combined we have an objection.

10 MR. SOTO: A separate objection, your Honor, would
11 also be that to the extent the witness is talking about
12 anything that has to do with the mediation, I think the
13 mediation order is still in place, and it's hard for me to
14 figure that out yet.

15 THE COURT: Well, I think it's a little bit broad to
16 prohibit the witness from talking about anything that has to
17 do with mediation. What the Court's order prohibits is
18 disclosure of anything that took place during mediation, and
19 the Court will abide that order, of course. Beyond that, the
20 objections are overruled. You may proceed.

21 BY MR. BARNOWSKI:

22 Q Did the committee have any other goals going into the
23 negotiations with the city? And, again, don't talk about
24 what was talked about with the city or the actual
25 negotiations.

1 A No. I would talk about how we approached it.

2 Q Right.

3 A The committee's objective, at least as I perceived it and
4 as one of their advisors what I believe the direction they
5 were giving to me was to do as best as we could -- and I
6 described the relative weighting of the claims, but to do as
7 best as we could to maximize the value of the claims. But we
8 viewed it in a -- within what I would call constraints or
9 context. The committee early on established or believed that
10 the city's objective, which had been stated early on in the
11 June presentation and the city had been very public and vocal
12 about, was a key priority of the proceeding -- and this was
13 before the filing, but even after the filing -- was that
14 Detroit be able to revitalize itself. Detroit had been --
15 and this was well-documented and discussed, you know, quite
16 broadly -- self-evident I think would be fair, at least from
17 my perspective, self-evident, that Detroit had been in
18 decline for a long time. And, you know, I'd been observing
19 that from a distance. And when you work with GM and
20 Chrysler, you can't help observe what's going on in Detroit,
21 so to me those -- that was self-evident that Detroit was in a
22 long-term decline and that part of the test of whether a
23 reorganization would be successful was whether or not Detroit
24 was given a reasonable chance to revitalize itself. So for
25 us we determined for some different reasons which I can talk

1 about, but we determined that anything we put forward we had
2 to in good faith feel was consistent with revitalizing the
3 City of Detroit. We felt that, number one, because we had no
4 expectation -- again, from the beginning, we had no
5 expectation that we were going to get a one-time lump sum
6 cash payout. We had these big claims. They are reducible to
7 present value. In theory, they could be resolved simply by
8 the city, you know, writing a check as it were for the whole
9 amount, and we would go away. We had no expectation that
10 that was feasible. It didn't take, again, long looking at
11 the public documents that the city -- were available to
12 anybody that the city would not be capable of writing
13 enormous checks. So for one -- so one reason we cared about
14 revitalization was at the end of the day we were relying on
15 the City of Detroit to be there to honor these promises out
16 on into the future. And while we felt like we had strong
17 legal arguments that no matter what the city agreed to on
18 pension in this case it should be protected by the
19 Constitution, the reality is, as we observed, when you get
20 yourself in bankruptcy, bad things happen. And so for us to
21 bet -- so we were, whether we liked it or not, betting on the
22 city because our promises, the promise -- the revised
23 promises that the city would make, whatever they would be,
24 would be promises that would pay out over time, and so we had
25 to have belief that revitalization could occur because if the

1 city continued in this long-term decline, the revised
2 promises it made would likely be challenged, not as a legal
3 matter but as a financial matter, so for that reason we were
4 concerned about revitalization. Second -- I'm sorry. Go
5 ahead.

6 Q No. I was going to say were there any other reasons why
7 you were interested in revitalization?

8 THE COURT: Excuse me. Before you answer that
9 question --

10 THE WITNESS: Yes, sir.

11 THE COURT: -- was the "we" that you referred to
12 many times in that answer you, Lazard, the committee, you and
13 Lazard, or some other answer?

14 THE WITNESS: Okay. Well, I was the leader of the
15 Lazard team, so I think I can speak for Lazard on this
16 matter. And I think I am reflecting the views of the
17 committee, yes. It is also Lazard's view, but I think in
18 this case it's coincident with the view of the committee --

19 THE COURT: Okay.

20 THE WITNESS: -- yes.

21 THE COURT: It would help me if you could -- if you
22 could explicitly state who your answers refer to.

23 THE WITNESS: Yes, sir. Okay.

24 BY MR. BARNOWSKI:

25 Q So the question was --

1 THE COURT: We're waiting for -- we're waiting for a
2 question. What was your question?

3 MR. BARNOWSKI: Right.

4 BY MR. BARNOWSKI:

5 Q The question was were there any other reasons why the
6 committee was interested in the city's ability to revitalize
7 itself through this bankruptcy?

8 A Yeah. I think the -- I think the committee also believed
9 that the political overlay -- this is a political
10 environment. The city is a political entity. There are many
11 stakeholders who are political entities who are involved in
12 this case whether it be the -- whether it be the other
13 counties or whether it be the State of Michigan itself, and
14 our perception -- the committee's perception was they had a
15 keen interest in revitalization as well, and so, again, we
16 felt like to put ourselves adverse to that view that
17 revitalization was key, we thought to put ourselves adverse
18 to that would make it very unlikely that we would be
19 successful in our advocacy to bring other stakeholders into
20 support of our overall view. So irrespective of whether we
21 were getting a long-term payout, which we were, but separate
22 and apart from that, we believed that the resolution of this
23 case would involve the -- would include the involvement of
24 other stakeholders, and, again, reading the newspapers,
25 watching -- and, again, everyone on the committee, you know,

1 lived in and around Detroit. They had views of what the
2 politics were, and so, again, the committee felt like being
3 on the wrong side of revitalization was just not a place that
4 would get us where we needed to go.

5 Q Okay. Now, you talked a little bit about the committee's
6 goals or purposes going into the negotiations. I want to
7 fast forward a little bit and just ask you did the committee
8 achieve all it hoped to do through the negotiations?

9 A No, I don't think we achieved all that we hoped to
10 achieve. Certainly in the beginning, again, we had been very
11 public and vocal about the fact that we thought the pensions
12 should be left untouched. I believe what the committee
13 thought and the reason they determined to support the plan
14 was we believe that we received enough, that it was enough to
15 get -- again, in the context of the situation, given the
16 constraints I've prior talked about, given the reality of the
17 various other stakeholders and the other contending matters
18 in the case, and given the alternative in the city's
19 solicitation, we felt like support of the plan was
20 appropriate and in the best interest of the people we were
21 representing. But there was -- you know, there was enormous
22 disappointment by the members of the committee that they were
23 going to be recommending to their fellow retirees that they
24 vote in favor of having their pensions reduced. That's a --
25 you know, in my experience, that's a challenging thing to ask

1 an elected or appointed representative to do.

2 Q Did the committee believe that the settlement proposal
3 would further the city's ability to revitalize itself in the
4 ways that you've described?

5 A I think the committee felt that the -- our settlement and
6 the POA generally would help to facilitate the revitalization
7 of the city. There are no guarantees. We did not view there
8 is guarantees, but we believed that it was a reasonable
9 amount that could be done in the context of a court
10 proceeding to set the stage for possible revitalization.

11 Q Okay. And putting aside the financial means of
12 revitalization, were there other purposes of the
13 revitalization or ways that the plan would further
14 revitalization in the committee's mind?

15 A Well, one thing we observed, some of it in the plan and
16 some of it simply in the city's behavior as we watched them
17 negotiate with us and with other entities, was we saw the
18 city taking a different view toward its workforce, and,
19 again, our view was that a workforce that is motivated and
20 excited about the opportunity to participate in the
21 revitalization of Detroit is an important element of that
22 revitalization. You know, we believed that the city needed
23 money, just, you know, money to remove blighted houses, to
24 buy new police cars, et cetera, and that was critical, and
25 that had to be provided for in the plan, but at the end of

1 the day, the face of the city and the execution of a plan is
2 by the human beings who work for the city. The city in the
3 end is nothing but its employees in terms of its governmental
4 role. It's nothing but the people. And so we observed the
5 city taking a different approach, and while we were not
6 directly involved in the collective bargaining or its public
7 and private statements to its active workers, you know, we
8 did have active worker representatives on our committee, and
9 we were observing what was going on. Many of our committee
10 members had social and familial relations with active
11 workers, and so we believed that that was another thing the
12 city was doing that to us was a positive sign that the city
13 really meant to do things different in the future and to try
14 to have a more constructive approach to solving problems and
15 to revitalizing itself.

16 Q One phrase that's been used in this proceeding a little
17 bit is "worker morale." Are you talking about worker morale,
18 or are you talking about something broader than that?

19 A Well, I'm not an English professor. I sometimes see -- I
20 sometimes think of the word "morale" a bit narrowly, you
21 know. Are the people enjoying going to work? That's
22 obviously important. But at least as I was trying to
23 describe this, I view it more broadly. The city was
24 dysfunctional, in my judgment, from the outside looking at it
25 before the case began. The city was dysfunctional. It had

1 difficult relations with all of its key stakeholders, as I
2 observed it. And so to me the decision to try to engage in
3 good faith negotiation -- and, by the way, that included us.
4 I mean we had very tough discussions, as I said, but we felt
5 like there was professionalism. We felt like the city was
6 sincere about revitalization, and that sincerity extended to
7 the treatment of other stakeholders, not just us. So to me
8 it's a deeper question than just, you know, are the employees
9 smiling, which is better than not, but that's not what I'm
10 trying to convey. What I'm trying to convey is that we saw
11 the city taking a fresh start to how it dealt with long-
12 seated problems, to be honest about them, and some of that
13 came back on us in a bad way because we had substantial
14 reductions in benefits that we'd been promised, and we didn't
15 like that. But at least -- but I think one of the things the
16 city persuaded us of over the course of the case was they
17 were sincere, so we didn't like what they had to say often,
18 but we felt that their commitment to revitalization was
19 sincere. And when we saw evidence of that, as to how they --
20 for instance, how they were treating the active workers, that
21 was to us a positive sign that our long-term interest was
22 going to be served and the revised promises we got would
23 eventually be honored.

24 Q In your years representing or negotiating with Chrysler,
25 with GM, with the steelworkers and all the restructurings you

1 talked about, have you observed that active workers care
2 about how retirees are treated in that kind of restructuring?

3 MR. WAGNER: Objection on relevance and foundation.
4 Unclear what treatment in those other matters bears -- how
5 that bears here.

6 MR. BARNOWSKI: Well, your Honor --

7 MR. WAGNER: And he's not -- he was not -- he's not
8 offered as an expert witness. He was specifically disclaimed
9 as an expert witness.

10 MR. BARNOWSKI: Your Honor, we don't believe this is
11 expert testimony. I'm asking him to, first of all --

12 THE COURT: What's the relevance?

13 MR. BARNOWSKI: The relevance is he's going to
14 explain what he saw in these negotiations, which are very
15 similar, and why he concluded that the active workers here
16 cared about how the retirees were being treated and were
17 treated through this negotiation, thereby helping build --
18 worker morale is the issue that the objectors have put into
19 play, but we would say it's a broader topic. It's actually
20 worker investment in the city. He's uniquely situated to
21 talk about that issue. He's been negotiating and involved in
22 these kind of things for 30 years, including both with the
23 government and with the steelworkers and now in this case,
24 and he's just going to give his -- what he observed factually
25 happened before him. And I'm just laying the foundation of

1 how he developed that opinion.

2 MR. WAGNER: Your Honor, then I have two additional
3 objections. One, to the extent he's testifying to what went
4 on in negotiations, that, I think, is covered by order. Two,
5 to the extent he's repeating or he's basing his views on
6 what's been said to him by others, that's hearsay.

7 THE COURT: I'll permit you to question the witness
8 on this subject in connection with his experience and
9 observations in this case.

10 MR. BARNOWSKI: Okay.

11 BY MR. BARNOWSKI:

12 Q Mr. Bloom, do you understand the limitation?

13 THE COURT: Why don't you --

14 MR. BARNOWSKI: Okay.

15 THE COURT: -- reask the question consistent with
16 the Court's ruling?

17 BY MR. BARNOWSKI:

18 Q Did you observe in the course of your work in this case
19 that -- and did you conclude that the actives would care how
20 retirees were treated through this plan of reorganization?

21 MR. WAGNER: Objection. Leading and hearsay.

22 THE COURT: Overruled. Go ahead, sir.

23 THE WITNESS: I think I observed it in two different
24 ways, one direct and one indirect. The direct way is that
25 there were members of our committee who were active -- one

1 was an active employee and one was a representative of active
2 employees. And in both those cases, I heard them say to me
3 directly that they were -- that the active employees did care
4 about how the retirees were treated and that that was
5 relevant to them in their view of what was right and what
6 should happen in the case. And second was while, again, I
7 was not involved in the collective bargaining negotiation
8 itself -- excuse me -- other members of our committee were
9 regularly in touch with other active workers who they knew --
10 as I said, family relations, et cetera -- and they also --
11 and they also reported the same thing.

12 MR. SOTO: Objection, your Honor. Hearsay.

13 MR. WAGNER: Yes. And I object to the second piece
14 on foundation grounds.

15 THE COURT: Both objections are overruled as
16 untimely.

17 BY MR. BARNOWSKI:

18 Q Tell me why? Why did you come to that conclusion?

19 A I mean in the case of the active -- in the case of the
20 members of the committee who were active, they told us. I
21 mean --

22 MR. SOTO: Objection, your Honor. Hearsay.

23 THE WITNESS: They told me. Excuse me.

24 THE COURT: Hold on.

25 THE WITNESS: I apologize.

1 THE COURT: When there's an objection, I need to
2 deal with it.

3 THE WITNESS: I'm sorry, sir.

4 THE COURT: I'm sorry, sir. Would you repeat that?

5 MR. SOTO: Hearsay. He's about to testify about
6 what somebody has taken out of this --

7 MR. WAGNER: Right. And just --

8 THE COURT: And you agree?

9 MR. WAGNER: I always agree with Mr. Soto. Just to
10 go back to --

11 MR. SOTO: Then why did he just roll his eyes at
12 that?

13 MR. WAGNER: He's just being nice. Just going back
14 to the prior point on the untimeliness, we don't know what's
15 going to -- I'd ask that the answer be stricken. We don't
16 specifically know.

17 THE COURT: Ah, that's a different question. That's
18 not untimely.

19 MR. WAGNER: Okay. And I would ask that it be
20 stricken to the extent he's relying on what other people told
21 him. Those people aren't here. It's clearly hearsay. It's
22 being offered for the truth. It should be stricken.

23 THE COURT: The motion is denied. You may proceed.

24 BY MR. BARNOWSKI:

25 Q Can you tell me why you came to that conclusion?

1 A The committee had vigorous discussions about how to
2 prioritize its position, about how to evaluate how the other
3 stakeholders in the case viewed things, and as part of those
4 conversations, you know, the committee met frequently. We
5 talked a lot. And it was the committee's belief that the
6 active employees were concerned, and we had active employees
7 who were putting that forward as a concern.

8 THE COURT: And for the record, I'll just say that
9 the Court overruled the hearsay objections and denied the
10 motion to strike on the grounds that the Court perceives that
11 this testimony is not being offered for the truth of it but,
12 rather, to establish why the committee was taking the
13 positions it was in this litigation. Go ahead.

14 MR. WAGNER: Thank you, your Honor.

15 BY MR. BARNOWSKI:

16 Q Were you surprised that this was the instruction or the
17 negotiation position you were being instructed to take; i.e.,
18 protect the -- that the actives care about how retirees are
19 treated?

20 A Was I surprised? I wasn't surprised at all. I'd had a
21 lot of experience in this matter, and it was consistent --
22 entirely consistent with my prior experience.

23 MR. WAGNER: Your Honor, I ask that that be stricken
24 because he's referring now back to his prior experiences in
25 some other matter.

1 THE COURT: I'm not sure what the witness' surprise
2 or how that's relevant here, so I'll grant the motion to
3 strike.

4 BY MR. BARNOWSKI:

5 Q Okay. One last topic, Mr. Bloom. Can you describe how
6 the OPEB settlement, Class 12, is designed to work?

7 A I think I can generally describe it, yes. Going into the
8 case, the city, like many similar employers, had a promise to
9 its -- to the people who'd worked there that it would provide
10 them with a healthcare benefit package after they retired,
11 and so it was a -- it was a -- it was what would be called a
12 defined benefit, meaning there was a benefit that was
13 provided. And while there were copays and deductibles,
14 ultimately the cost of the benefit was borne by the employer,
15 and the employee had a defined -- had a defined amount they
16 had to pay, but the benefit was the responsibility of the
17 employer. In the course of the negotiation -- in the course
18 of the negotiation, we determined that we were willing to
19 accept -- I guess I would describe it as two different kinds
20 of changes to that promise. One was in the nature of the
21 promise. What replaced a defined benefit is what I would
22 call a defined contribution. In other words, the city
23 eventually provided to the two VEBAs notes, financial
24 instruments, that had a fixed obligation, a fixed interest
25 rate, and a fixed period of payment. That defines entirely

1 the city's obligation on this benefit. And if those notes
2 trade well in the marketplace, then they'll be worth more.
3 If they trade poorly in the marketplace, they'll be worth
4 less. But whatever they're worth -- and if the notes are
5 sold and the money is reinvested well, there will be more to
6 provide benefits. If the money is reinvested poorly or
7 there's a bad stock market or whatever it is, there will be
8 less. So all of the risk as to whether or not any particular
9 level of benefits could be maintained is borne by the VEBA
10 beneficiaries, by the people themselves, and the trustees
11 will have to decide how much to reduce benefits, how long to
12 continue, all those sorts of questions, so there's a
13 fundamental what I would call a risk shift between the city
14 as obligor and this trust as obligor, and the city is solely
15 an obligor regarding a note of fixed amount, fixed duration,
16 fixed interest rate, so I think a fundamental change in
17 approach on the benefit.

18 And then second, the level of -- the level of
19 support, a stipend of, depending on the exact person, 150 or
20 so dollars a month, 125 -- there are different pieces and
21 parts, but roughly speaking -- would not permit the purchase
22 of healthcare benefits anywhere near the level of -- that
23 people enjoyed prior to the case, so there's both an absolute
24 reduction in the level of healthcare that people can buy with
25 the stipend, and there's this risk shift that I prior

1 discussed.

2 Q Is the city getting out of the healthcare business?

3 A The city is getting out of the healthcare business
4 entirely. The city is in the business of servicing a
5 financial obligation. That is the full extent of their
6 promise.

7 Q And you talked about a stipend. Is the city paying a
8 stipend?

9 A No. The only source of payment of the stipend is either
10 the interest on the note or the selling of pieces of the note
11 and, therefore, the reinvestment of the proceeds of that
12 sale, but it's a fixed pot of money, and the size of that
13 stipend -- there will be an initial setting of it, but the
14 size of that stipend over time is entirely dependent on, as I
15 said, how well the note trades in the marketplace if and when
16 it will be sold, if it's sold for a lot or a little, and
17 whether the proceeds of the sale are invested in a way that
18 they make a lot of money on return on investment or they
19 don't. And that will be the sole determinant of what the
20 size of that stipend is. The city will not pay the stipend.
21 The trust will pay the stipend.

22 Q What is the amount of those two notes, the cumulative
23 amount?

24 A \$450 million.

25 Q Do you have an understanding of what the committee was

1 hoping to accomplish or achieve through pursuing a note for
2 \$450 million in terms of benefits?

3 A Yeah. I mean the city -- sorry. The city. I apologize.
4 I think the committee had a view when we settled that if a
5 series of things occurred in terms of the value of the note
6 and the reinvestment of the proceeds that we had a reasonable
7 probability of being able to maintain the 214 benefit
8 program, but, again, I think that the committee understood
9 that that was based on a series of assumptions, and while it
10 could be a little better, I think there was more -- candidly,
11 more risk to the downside than the upside, but the hope was
12 that the 214 benefit could be maintained without inflation,
13 so -- and obviously there's generally inflation in the
14 economy. This has to last 30 years, so from a value
15 perspective, the expectation is the stipend would be worth
16 less, not worthless, but worth less in the future than it
17 would be out of the -- out of the gate.

18 Q And has Lazard examined those assumptions to determine
19 whether it is reasonably likely that the notes will allow the
20 VEBAs to provide coverage similar to 2014?

21 A Yes.

22 MR. WAGNER: Objection, your Honor. This is veering
23 off into what I believe is expert testimony. He's not an
24 expert.

25 MR. BARNOWSKI: I'm not asking for his expert

1 testimony, your Honor. I'm just asking him whether the notes
2 will spill off enough income to purchase the same benefits.
3 It's calculations.

4 MR. WAGNER: That's clearly expert testimony. We've
5 been presented with no calculations. No one prevented him
6 from putting in an expert report, but -- and he was
7 originally identified as a potential expert. He didn't put
8 in an expert report, and he specifically disclaimed at his
9 deposition that he would be an expert.

10 MR. BARNOWSKI: Your Honor, I don't believe that
11 this is expert testimony. This is solely an analysis of the
12 \$450 million, whether it will spill out enough cash to allow
13 the VEBAs to purchase similar benefits.

14 MR. WAGNER: I think that's -- I'm sorry. I think
15 that that's expert testimony.

16 THE COURT: I have to agree. The objection is
17 sustained.

18 BY MR. BARNOWSKI:

19 Q Last question, Mr. Bloom. What happens if the
20 assumptions don't work out? Who bears the burden or the
21 risk?

22 A Whatever the assumptions are, if the note is not worth as
23 much as one might hope it would be, if the proceeds of the
24 note are not reinvested in a manner that they can earn
25 substantial interest, then that risk entirely sits on the

1 retirees who will see their stipends reduced.

2 MR. BARNOWSKI: Thank you, Mr. Bloom. No further
3 questions.

4 CROSS-EXAMINATION

5 BY MR. WAGNER:

6 Q Good morning, Mr. Bloom. Nice to meet you in a more
7 formal setting than an elevator at ten o'clock at the hotel.

8 A Good morning.

9 Q Jonathan Wagner on behalf of the COPs. Sir, you gave
10 some testimony about employee morale a few minutes ago. Do
11 you recall that?

12 A Yes.

13 Q And am I right the committee has conducted no formal
14 survey of active employees bearing on the morale issue?

15 A The committee did not conduct a formal -- any formal
16 survey. The committee has a number of interactions with
17 active employees all the time, but there was no formal
18 survey.

19 Q And the committee had the means to conduct such a survey,
20 didn't it?

21 A I'm not sure that the committee had the resources to do
22 that, but the committee did not.

23 Q Well, Lazard through March has billed over a million
24 dollars in this matter; right?

25 A Sounds right.

1 Q And are you aware that a survey like this costs about
2 \$50,000?

3 A I'm not aware of the cost of it. The committee didn't do
4 it.

5 Q And you've presented no documents today bearing on the
6 morale issue, have you?

7 A I don't believe so.

8 Q Now, sir, you testified that you and the committee have
9 been very public and vocal about this matter; correct?

10 A Yes.

11 Q And you've made several public statements about this
12 matter?

13 A I believe I've made a few, yes.

14 Q And you take care when you make those public statements,
15 don't you?

16 A I try to.

17 Q Now, do you remember stating the following, quote, "The
18 city seeks to use assumptions regarding the health of the
19 pension plans that are significantly different from those
20 used by the State of Michigan and hundreds of cities across
21 the state and around the country"? Do you recall you made
22 that statement publicly?

23 A I do.

24 Q And you were specifically referencing the discount rate
25 for the pension funds; right?

1 A Yes, I was.

2 Q Now, Segal is the actuary for the Retiree Committee;
3 correct?

4 A Yes.

5 Q And by this time the Segal folks had told you that the
6 discount rate used in Michigan -- other Michigan pension
7 funds was eight percent; right?

8 A Yes, they had.

9 Q And you made the statement in February of 2014?

10 A I believe that's correct.

11 Q So let me just understand. Before the settlement, the
12 Retiree Committee's position was the city was proposing a
13 discount rate that was too low; right?

14 A Yes.

15 Q Now that you've settled, the Retiree Committee is urging
16 a rate that's much lower; correct?

17 A The Retiree Committee is urging -- was urging the support
18 for an overall settlement that had many elements. Among
19 those elements was the city's discount rate, but this was a
20 multi-part settlement. It had many different pieces, and
21 among the pieces the committee determined that the use of the
22 lower discount rate was acceptable in light of the overall
23 settlement.

24 Q And, sir, were you in court yesterday when the Segal
25 actuary testified?

1 A I was not.

2 MR. WAGNER: Nothing further.

3 THE COURT: Any other questions for the witness?
4 No? All right, sir. You are excused. Thank you very much
5 for coming today.

6 THE WITNESS: Thank you.

7 (Witness excused at 9:27 a.m.)

8 THE COURT: Mr. Cullen, can we get a printout of
9 that latest schedule of witnesses? Do you have one
10 available?

11 MR. CULLEN: I'll make one for you.

12 THE COURT: Or maybe if you could just flash it on
13 the screen again, we could just write it down. It was just
14 for today and tomorrow; right?

15 MR. CULLEN: Could you --

16 THE COURT: Would you write it down for me?

17 MR. PEREZ: And, your Honor, I just wanted to make
18 sure that the Court was aware that last night around ten
19 or -- ten o'clock last night we did file the stipulation with
20 respect to the adjournment.

21 THE COURT: Right. And I entered the order -- or
22 had it entered this morning.

23 MR. PEREZ: Okay. Fine. Thank you.

24 MR. HAMILTON: The witness is on the way from the
25 jury room, your Honor.

1 THE COURT: Okay.

2 MR. HAMILTON: Good morning, your Honor. Robert
3 Hamilton of Jones Day on behalf of the City of Detroit. Our
4 next witness is Sue McCormick, the director of the Department
5 of Water and Sewer. We have binders of the exhibits that I
6 want to ask of her. Can I approach, your Honor, with your
7 set?

8 THE COURT: Yes, please. Please raise your right
9 hand.

10 SUE F. MCCORMICK, CITY'S WITNESS, SWORN

11 THE COURT: Please sit down.

12 DIRECT EXAMINATION

13 BY MR. HAMILTON:

14 Q Good morning, Ms. McCormick.

15 A Good morning.

16 Q Can you tell the Court who you are?

17 A I'm Sue McCormick, and I'm the current director of
18 Detroit Water and Sewage Department.

19 Q When did you start as the director of the Department of
20 Water and Sewerage?

21 A In January of 2012.

22 Q All right. What were you doing prior to that?

23 A I was the public service administrator in the City of Ann
24 Arbor. I had responsible charge for all of the city's
25 infrastructure there.

1 Q And did that include water and sewer at Ann Arbor?

2 A It did.

3 Q All right. And prior to -- when did you start at the --
4 in the City of Ann Arbor?

5 A I was there for 11 years. I had started in 2001.

6 Q And prior to that, where did you work?

7 A I worked 22 years for the Lansing Board of Water and
8 Light.

9 Q And what did you do there?

10 A I did a variety of things. I grew up in my career there
11 starting in the environmental science lab doing testing for
12 the utility. I worked in systems planning, ran the
13 environmental lab, and ultimately I spent the last ten years
14 I was there helping Lansing build a regional water system in
15 conjunction with other local communities.

16 Q Do you hold a college degree?

17 A I do. I have a bachelor of science from Michigan State
18 University.

19 Q And what was the major or what was the --

20 A It's in biological sciences.

21 Q All right. From Michigan State. And are you a member of
22 any particular professional organizations?

23 A I am, several, including the American Water Works
24 Association where I've served in a variety of capacities,
25 including as vice president of the association.

1 Q What is the American Water Works Association?

2 A It's a professional association that represents about
3 40,000 professionals that provide water supply services
4 across the U.S. and actually across the world.

5 Q What are your duties as the director of the Department of
6 Water and Sewerage?

7 A Well, I'm the chief executive officer, so the full gamut
8 of the chief executive officer including making sure that we
9 meet all regulatory compliance standards, that we have
10 harmonious labor relations, that we meet our financial
11 metrics, performance metrics. I interface with all of the
12 local communities that we provide service to and certainly
13 with the governance board for the utility as well.

14 Q All right. When you first started, what was the nature
15 of the -- as the director of the department, what was the
16 nature of your work?

17 A Well, I started with a very significant challenge. In
18 November of 2011, a court order was issued, Judge Sean Cox,
19 who had oversight of the department as a result of over a 30-
20 year case history of intermittent violations of the Clean
21 Water Act. Judge Sean Cox had worked with a root cause
22 committee and had developed a set of solutions to addressing
23 the long-term noncompliance issues. That order required in a
24 fairly short time frame a number of substantial changes to
25 occur at the department to create a quasi independent

1 department I guess I would describe it, to become independent
2 in several key areas, including finance, labor, law, and
3 procurement.

4 Q All right. Does the phrase "management initiatives" have
5 meaning to you?

6 A It does.

7 Q Can you explain to the Court what that refers to in the
8 context of DWSD?

9 A So in the context of DWSD, management initiatives means
10 in addition to having these new stand-up independence
11 abilities establishing this new capacity within the
12 department that the department had never had before, we also
13 took a look at what the department's history was in terms of
14 rate increases. The rate increases were quite substantial,
15 and they were projected to be quite substantial for the
16 foreseeable future, on the order of eight to eight and a half
17 percent per year. Stemming the tide of those rate increases
18 in order to assure affordability in the community for
19 services at the same time of standing up these new
20 independence meant that we had to be very creative. I did an
21 assessment of my own over the first 90 days talking with
22 employees throughout the department, talking with a number of
23 our customers, and then I commissioned a study, a 90-day
24 study by EMA, a well-known consultant, to take a look at what
25 the potential was to reinvent the department, to optimize its

1 operations. And in that process, we identified a number of
2 key initiatives to assist the department in becoming both
3 more effective as well as more efficient.

4 Q Can you describe for the Court generally what some of
5 those initiatives are?

6 A One of them -- probably one of the most substantial in
7 terms of our early accomplishments was taking a look at the
8 number of different job classifications that were described
9 in the department. I heard from many employees that in their
10 conduct of their work that based on the narrow description of
11 their jobs, they could do certain tasks, but then they had to
12 stop. And even though they might be capable, may have even
13 held a position previously where they did those tasks, they
14 had to hand it off to someone else because of the narrow
15 nature of their job classification. So in working with
16 employees, we put job design teams in place of employees that
17 worked in those classifications, and we consolidated roughly
18 270 different job classifications into just over 50. We
19 created career pathing for individuals. These broad-banded
20 jobs take a lot of delay, allow a lot more effective
21 operation, and ultimately because of that we can downsize the
22 organization quite substantially. In fact, we have reduced
23 the organization by about 30 percent in the last two and a
24 half years.

25 Q You used the phrase "organizational optimization"?

1 A We do. In our discussion with employees, this is -- we
2 want to be clear that our path of continuous improvement is
3 not something that ends at a number. We try to avoid using a
4 final number around most of our initiatives because we want
5 the organization to adopt a continuous improvement culture.

6 Q Do you have any management initiatives with respect to
7 increasing the department's independence from the city?

8 A Yes. We are going through -- in our finance area, for
9 instance, we have an initiative that's called financial
10 transformation, and this gets to the issue of conducting many
11 of the items internally to the department that have never
12 been done there before. Treasury management, for instance is
13 one of them. Representing ourselves independently as we go
14 for bond market and financing is another. And so that's an
15 example of the type of thing that we're doing.

16 Q And then what initiatives are you undertaking with
17 respect to improving the financial stability of the
18 department?

19 A There have been several. Probably the one that is most
20 notable, we have worked with our customers -- our major
21 customers, primarily the three counties, in looking at trying
22 to achieve revenue stability on the sanitary sewer side of
23 our business, so we are a business whose revenues can vary
24 quite significantly from year to year because a lot of that
25 is based on weather variability, but we're also a very large

1 fixed cost business, so much of our obligations each year are
2 based on already made capital investment and debt service,
3 the number of employees we have. Very little of our costs
4 are actually variable, but the revenues are quite variable
5 because of unit cost pricing. The revenues can vary quite
6 substantially based on weather. The customers recognize this
7 issue along with DWSD, and we spent nearly a year, about ten
8 months, having good conversation with our customers about how
9 we in that environment provided a situation that made every
10 customer feel that the charges were equitable to them but
11 that also provided revenue stability for the department. And
12 as a result of that, as of July 1st of this year, when we
13 developed our budget, we took a look at the allocation of
14 costs and revenues on average over the preceding history, and
15 we agreed to shares, and our customers are now paying a fixed
16 share of our actual budget costs, and they make those
17 payments monthly so that at the end of the year, our budgeted
18 revenues are guaranteed.

19 Q All right. And did you establish any goals for the
20 department as to what level of rate increases you would seek
21 on an annual basis going forward?

22 A Yes. As a part of recognizing the -- both the
23 opportunity that we had for savings and recognizing that we
24 wanted to keep necessary revenue adjustments at or below the
25 cost of service, we set a goal of reducing those financial

1 plan projections of eight to eight and a half percent to 50
2 percent of that or no more than four percent in our financial
3 plan moving forward.

4 Q And when you say four percent, what does that four
5 percent relate to? What does it mean?

6 A It's actually new revenue, so, for instance, if this
7 year's revenue requirements for the utility are 800 million,
8 then next year they would be no more than 832 million. That
9 will translate to a variety of calculations of rates for
10 various communities depending upon how they use service, but
11 the revenue requirement for the department's operation, the
12 goal is to increase no greater than four percent each year.

13 Q All right. Did you end up preparing a report, what was
14 called a compliance report, with respect to complying with
15 Judge Cox's orders?

16 A Yes. As a part of the assignment to the director, the
17 Court asked that compliance reports be provided periodically
18 as we moved forward, and that included a final compliance
19 report that was filed as well.

20 Q When did you prepare and file the final compliance report
21 that you just referred to?

22 A That was in 2013.

23 Q In March of 2013?

24 A Correct.

25 Q And as a result of that, what order did Judge Cox enter?

1 A He issued an order dismissing the case, and ultimately
2 his determination was the department had achieved substantial
3 compliance with those items that he had laid out for the
4 director to accomplish, and we also had at that point
5 established a compliance record with the Clean Water Act.

6 Q Do you continue to give periodic reports on compliance
7 with the initiatives that were set forth in the court orders?

8 A We do, no longer to the Court, of course, but to my board
9 of directors. Every month in the director's report I report
10 on compliance issues.

11 Q And are those reports also available to the public?

12 A All of that is available to the public.

13 Q Where is it available?

14 A We post it on our Internet.

15 Q All right.

16 MR. HAMILTON: If I could, I'd like to ask if we
17 could bring up Exhibit M to the disclosure statements. It's
18 City Exhibit 3 at page 190 of 2012. 186. So many different
19 numbers, your Honor. It's actually page 685 of the exhibit.

20 THE COURT: All right.

21 THE WITNESS: Glasses. Thank you.

22 THE COURT: Do you need your glasses, ma'am?

23 THE WITNESS: Well, we'll see. If I can get the
24 dust off of these, they may work.

25 THE COURT: Busted.

1 MR. HAMILTON: Are they in here, too?

2 THE WITNESS: Yes. Thank you.

3 MR. HAMILTON: May I approach, your Honor?

4 THE COURT: Yes.

5 THE WITNESS: Yours are either greater or less
6 magnifying than mine. I'm not quite sure which. Okay. I
7 can see now.

8 BY MR. HAMILTON:

9 Q Ms. McCormick, are you familiar or are you aware of these
10 projections?

11 A I am.

12 Q Do you have a general understanding as to how these
13 projections came about?

14 A I believe so. If this is a ten-year projection -- again,
15 I'm just looking at the caption here, this ten-year
16 projection. Can you tell me when this was done?

17 Q Yeah. This is --

18 MR. HAMILTON: Can we do the previous page?

19 BY MR. HAMILTON:

20 Q This is Exhibit M to the disclosure statement that the
21 city filed.

22 A All right.

23 Q Do you have an understanding as to how these projections
24 came about?

25 A I do.

1 Q Can you tell the Court what your understanding is?

2 A The financial projections here are based on -- are
3 these -- I'm sorry. I'm going to back up. I'm trying to
4 understand. When you say "of the disclosure statement,"
5 you're talking about in the bankruptcy?

6 Q Yes, for the plan of adjustment that was --

7 A For the plan of adjustment.

8 Q -- proposed by the city.

9 A Okay. So these are the Conway MacKenzie projections.
10 Okay. Conway MacKenzie was retained to do a ten-year
11 projection for DWSD. DWSD, at this particular point in time,
12 was not doing ten-year projections. We had a five-year
13 projection. The projection was also intended to reflect
14 changes that were occurring that would impact DWSD's
15 financial projections as a result of the plan of adjustment.
16 The DWSD projections would not have included that nor would
17 we have known what those impacts might be. In this
18 particular case, we worked with Conway MacKenzie providing
19 information from DWSD's financial projection so that they
20 could prepare a ten-year projection.

21 Q And what was the time period that you were providing this
22 information to Conway when they were preparing these
23 projections? How long ago was this?

24 A I believe this was like in the fall of 2012.

25 Q '13? I'm getting my years mixed up.

1 A Perhaps I am, but --

2 Q It was after the bankruptcy was filed; is that correct?

3 A Oh, that's true. In the fall of 2013.

4 Q Okay.

5 A The years run together. My apologies.

6 Q And at that time, I believe you said the department
7 didn't have ten-year financial projections; is that right?

8 A That's correct.

9 Q Can you describe for the Court what kind of projections
10 the department did have at that time?

11 A The projections the utility was doing at that time were
12 those that were more pertinent to taking a look at near term
13 impacts for rate purposes, so the department was preparing
14 both five-year CIPs, capital investment projections, as well
15 as five-year financial forecasts.

16 Q All right. And are the -- the five-year CIPs, are those
17 submitted to the Board of Water Commissioners for approval?

18 A They are on an annual basis, so even though it's a five-
19 year plan, it's renewed annually and submitted to the Board
20 of Commissioners for approval.

21 Q All right. So in the summer of -- late summer of 2013,
22 you had a five-year stip that had been approved by the Board
23 of Water Commissioners; is that right?

24 A That's correct.

25 Q And you had one -- one for water and one for sewer; is

1 that right?

2 A That's correct.

3 Q Okay. How did Conway -- or what information did Conway
4 use to project what the department's capital improvement
5 programs would be over a ten-year period?

6 A At that particular point in time, OHM had been retained
7 to prepare a ten-year forecast for capital.

8 Q Was the Department of Water and Sewer involved in working
9 with OHM to prepare those forecasts?

10 A We were. There were a number of master planning
11 documents that were provided to them, consultant reports from
12 various sources, so we worked with OHM to assemble all of
13 that information and give it to them for the purposes of an
14 independent forecast.

15 MR. HAMILTON: Can we bring up City Exhibit 178?

16 BY MR. HAMILTON:

17 Q Ms. McCormick, are you familiar with this document?

18 A I am.

19 Q And what is this document?

20 A This is the ten-year CIP that was prepared. OHM was the
21 lead advisor. They had held the contract. Many of the other
22 consultants that you see listed here had specific experience
23 relative to different asset classes at DWSD.

24 Q And what did the people that were involved in preparing
25 this ten-year CIP do in terms of interacting with your

1 department to prepare that document?

2 A They gathered information from all of the plans. I
3 believe they interviewed people in some of our facilities as
4 well to see what might be different from what was in plans
5 that might have been several years old. They did a pretty
6 comprehensive independent evaluation.

7 Q And how does the CIP forecast for the first five years in
8 this document generally -- do you have a general
9 understanding as to how those forecasts compare to the
10 department's five-year capital improvement plan that had been
11 approved by the Board of Water Commissioners?

12 A My recollection is they were similar in nature. I would
13 have to take a look at them to see what specific differences
14 there might be, but certainly anytime you're at a point in
15 time there may be more current information, but I believe
16 that they're generally similar.

17 Q Okay. All right.

18 MR. HAMILTON: Can we go back now to the previous
19 exhibit, which was City Exhibit 3, at page 6 --

20 UNIDENTIFIED SPEAKER: 685.

21 MR. HAMILTON: 685. Thank you.

22 BY MR. HAMILTON:

23 Q All right. Now, in the ten-year projections that
24 Conway did, I believe you said they used the OHM projections
25 for capital improvements for ten years; is that right?

1 A That's correct.

2 MR. HAMILTON: Can we go to 692? And can you just
3 expand the top three lines there including the text, if you
4 could? All right.

5 BY MR. HAMILTON:

6 Q All right. Ms. McCormick, can you tell the Court what
7 you understand these figures to show?

8 A These figures show basically the first five years of a --
9 of capital forecasts based on the assembly of projects, and
10 then in later years, in addition to the identified projects,
11 they identify what appears to be, from my understanding of
12 this, basically the free -- what we would call available
13 revenue at the end of a year, so after all expenses -- after
14 all expenses are accounted for, these are dollars that can be
15 used for any purpose.

16 Q So on the line that says "unidentified capital projects,"
17 it has dash marks for every year up until 2020, and then
18 there's positive numbers there.

19 A Correct.

20 Q What do those positive numbers reflect is your
21 understanding?

22 A On our balance sheet generally we would show after all
23 obligations are met we will end up with net revenue, which is
24 available for any purpose, and it appears that that's what
25 they have identified here as being available for unidentified

1 capital projects.

2 Q All right. And the top line are the projects that were
3 recommended in the OHM report; is that right?

4 A I believe so, yes.

5 Q Okay. All right. Since the time that Conway MacKenzie
6 prepared these ten-year forecasts for the department, has the
7 department itself prepared its own updated financial
8 projections going forward?

9 A Yes. And most recently as we were preparing to go out
10 for bond financing, we did an updated CIP on the sanitary
11 sewer side, which was actually adopted by our board. We
12 would have done a similar sort of thing on the water side,
13 but we weren't early enough in the process to anticipate the
14 refunding through our tender process to have the board do
15 that, but we do have a more current water forecast as well.

16 Q All right. And I want to -- I want to go through in
17 detail how those were -- the sequence of how you created
18 those.

19 A All right.

20 Q Did you prepare and get board approval of a new water
21 capital improvement program sometime in the winter of 2013?

22 A As a part of our annual process of going through the
23 budget and ratemaking process, we have the board consider a
24 updated capital improvement plan. They would have done that.
25 I don't know if they did it in December of 2013 or January of

1 '14, but it would have been in roughly that time frame.

2 MR. HAMILTON: Can we bring up City Exhibit 193?

3 BY MR. HAMILTON:

4 Q Ms. McCormick, what is this document?

5 A This is the updated water supply capital improvement
6 program that the board approved in December of 2013.

7 MR. HAMILTON: Your Honor, I would move City Exhibit
8 193 into evidence.

9 MR. SOTO: No objection, your Honor.

10 THE COURT: It is admitted.

11 (City Exhibit 193 received at 9:53 a.m.)

12 BY MR. HAMILTON:

13 Q All right. Now, was there also a new CIP for sewer that
14 was approved at approximately the same time in December --

15 A Yes, there was.

16 Q -- 2013? Okay. Did the department prepare and get board
17 approval of a new budget for fiscal year of 2015?

18 A Yes, they did.

19 Q Approximately when did they get that approval?

20 A Again, we would generally be having the conversation
21 following or in conjunction with the capital improvement
22 program, and then shortly after the CIP, the board would have
23 also adopted a budget, so in the same time frame, probably
24 into January of 2014.

25 Q Okay. And I believe you said that you even prepared a

1 more updated CIP for sewer; is that right?

2 A We did.

3 Q Why was that?

4 A Because we were getting ready to go out for bond
5 financing, and there were several things that had materially
6 changed, and we wanted to make sure that we had the most
7 current CIP approved by the board as we went into financing.

8 MR. HAMILTON: Can you bring up City Exhibit 205?

9 BY MR. HAMILTON:

10 Q All right. Do you recognize this document,
11 Ms. McCormick?

12 A I do.

13 Q What is this document?

14 A This is the CIP that we prepared for the board as we were
15 getting ready for financing, and this was adopted by the
16 board on July 9th of 2014.

17 Q And is this the document that updated the CIP for sewer
18 that had been approved back in December?

19 A Yes, it is.

20 Q Okay.

21 MR. HAMILTON: Your Honor, I would move Exhibit --
22 City's Exhibit 205 into evidence.

23 MR. WAGNER: No objection.

24 THE COURT: It is admitted.

25 (City Exhibit 205 received at 9:55 a.m.)

1 BY MR. HAMILTON:

2 Q All right. Ms. McCormick, what happened in August of
3 this year that consumed much of the time of senior management
4 in the department?

5 A Yeah. Well, actually, we started right around Memorial
6 Day talking about -- we had been working for some time to
7 take a look at new money financing for the sewer system. We
8 needed dollars in order to continue our capital improvement
9 program. As a part of those discussions with our financial
10 advisors, we identified which was a much bigger concern, and
11 that was the long-term availability of capital. In
12 conjunction with our financial advisors and underwriters and
13 as a result of some mediation, we presented an opportunity to
14 the market for a voluntary tender of DWSD bonds, a refunding,
15 refinancing as well as new money. And in that process, we
16 were -- we moved forward for financing.

17 Q All right. And in connection with that process, did you
18 prepare updated financial forecasts for the department?

19 A We did. We prepared updated financial forecasts. We did
20 this update for the CIP, and we did very extensive
21 preparation of preliminary operating statements in order for
22 the market to understand the situations that were going on at
23 DWSD --

24 Q And were those operating --

25 A -- in full disclosure.

1 Q Were those operating statements included in the official
2 statements that were issued for the bond offering?

3 A They were.

4 Q All right.

5 MR. HAMILTON: Can we bring up City Exhibit 637?
6 Can you just like blow up the first top fourth of the
7 document? Thanks.

8 BY MR. HAMILTON:

9 Q Ms. McCormick, do you have an understanding of what this
10 document is?

11 A It is. This is the final OS as a result of that
12 financing. This is dated August 27th, 2014.

13 Q All right. And is it in this document that you included
14 your most updated and accurate financial projections for the
15 department?

16 A It is, yes.

17 MR. HAMILTON: Can you go to page 114 of this
18 document, and can you blow up just the top half of it?

19 BY MR. HAMILTON:

20 Q All right. Are these the most updated projected
21 financial forecasts for the department for water?

22 A It is.

23 Q All right.

24 MR. HAMILTON: Your Honor, I would move City Exhibit
25 637 into evidence.

1 MR. SOTO: No objection.

2 THE COURT: It is admitted.

3 (City Exhibit 637 received at 9:58 a.m.)

4 MR. HAMILTON: All right. Can we bring up City
5 Exhibit 636?

6 BY MR. HAMILTON:

7 Q Do you recognize this document, Ms. McCormick?

8 A I do. This is the official statement dated the same,
9 August 27th. This is the final official statement as a part
10 of that same financing, and this is for the sewage disposal
11 system.

12 MR. HAMILTON: And can you go to page 118 of this
13 document and blow up the first half? It's the bottom right-
14 hand corner. That one, yeah.

15 BY MR. HAMILTON:

16 Q All right. Are these the most updated and accurate
17 financial projections for the sewer service at the
18 department?

19 A Yes.

20 Q All right.

21 MR. HAMILTON: Your Honor, I would move City Exhibit
22 636 into evidence.

23 MR. WAGNER: No objection, your Honor.

24 THE COURT: It is admitted.

25 (City Exhibit 636 received at 9:59 a.m.)

1 BY MR. HAMILTON:

2 Q Ms. McCormick, what are the two or three most significant
3 categories of changes in the financial projections that are
4 reflected in these official statements versus the projections
5 the department had back in the early fall of 2013?

6 A Well, there would be several, but I think most
7 significantly we would have had a -- we would have an -- add
8 an additional year where we would have had actual performance
9 numbers.

10 Q That's for fiscal year what? Two thousand -- the one
11 that ended on June 30th of 2014?

12 A Right. Here we have the unaudited results for 2014.
13 We'd have had final audited for '13 and unaudited results for
14 '14, so that would have been substantially different. In
15 addition to that, this is the first forecast, I believe, that
16 the department issued officially that would have included at
17 least our estimate of the impacts of the plan of adjustment,
18 and it would have also reflected the results of the tender
19 process.

20 Q All right. And also had you modified in any material way
21 the capital improvement plans with the department from fall
22 of 2013 to August of this year?

23 A Yes, and as indicated previously in the documents that we
24 looked at that were updated by the board.

25 MR. HAMILTON: Can we go -- can we go to 637, page

1 110? No. I must have the wrong --

2 THE WITNESS: This is 636, 110?

3 MR. HAMILTON: There we go. All right. Can you
4 blow up the fourth and fifth -- no, the one above. It
5 says -- yeah, those two.

6 BY MR. HAMILTON:

7 Q Ms. McCormick, can you describe the variance for the
8 Court between what had been budgeted for fiscal year 2014 and
9 what actually happened?

10 A Um-hmm. So I mentioned, I think, earlier that one of the
11 things that is quite significant to water and sewer utilities
12 is the variation in sales from year to year primarily
13 weather-driven, and, again, we typically project for budget
14 purposes what we consider to be a normal weather year.
15 Unfortunately, we've had a couple of back to back very wet
16 weather years, and as a result of that, the expected water
17 sales volume was lower than anticipated. In addition to
18 that, the level of bad debt was higher than what was
19 anticipated, some of this most substantially due to a couple
20 of significant increases in bad debt associated with local
21 agencies in financial distress, including the City of Detroit
22 and the Detroit Public Schools.

23 Q And can you describe -- or expand a little bit about
24 that, about the bad debt associated with the City of Detroit
25 and the public schools -- and the public school system?

1 A City of Detroit had made little to no payment of their
2 utility bills for the year preceding bankruptcy, and they had
3 made until very recently little to no payment on their debt
4 during bankruptcy, their utility bills during bankruptcy.

5 Q What about the school system?

6 A The school system had a amount --

7 THE COURT: Excuse me one second.

8 THE WITNESS: I'm sorry.

9 THE COURT: I'm sorry. When you say "City of
10 Detroit utility bills," are you talking about the bills that
11 the city itself owes or that its residents owe?

12 THE WITNESS: The municipal government.

13 BY MR. HAMILTON:

14 Q And can you describe for the school system its bad debts?

15 A The school system has been struggling for a couple of
16 years. A year ago they were \$10 million in owing to the
17 department. They did enter into a payment arrangement and
18 were able to reduce that, but we still have a bad debt
19 remaining of over \$5 million.

20 Q All right. And then the second paragraph here refers to
21 operating expenses being estimated at over \$9 billion under
22 budget. Do you see that?

23 A Um-hmm.

24 Q Can you describe for the Court what that reflects?

25 A This is basically the result of the department's

1 optimization, and we have gone into each of the last several
2 years projecting a natural attrition experience as well as a
3 cost constrained objective, but we have been very successful
4 in overachieving our reductions.

5 Q All right.

6 THE COURT: Can we bring up page -- Exhibit 636,
7 which is the sewer official statement, page 114? And can you
8 blow up those two paragraphs there? Yes.

9 BY MR. HAMILTON:

10 Q All right. Ms. McCormick, did you have a similar
11 experience with budget variances for the sewer department for
12 the fiscal year 2014?

13 A That's correct.

14 Q Could you describe that for the Court?

15 A Very similar. On billable wastewater volumes, again,
16 weather impacts relate to that. And while one might think
17 wet weather means more wastewater billable volume, in fact,
18 when the water billable volume goes down, the sewerage
19 charges on wastewater return are much greater than those for
20 what we would call dilute strength water, which is
21 stormwater, so from a revenue standpoint, it's still a net
22 negative experience for us. And the same issues that I
23 mentioned in terms of bad debt apply here as well.

24 Q All right.

25 MR. HAMILTON: Can we go now to City Exhibit 637 at

1 page 110? And can you blow up the bottom paragraph under
2 fiscal year 2015 budget?

3 BY MR. HAMILTON:

4 Q All right. Ms. McCormick, can you describe what the
5 revenue projections were in the fiscal year 2015 budget as
6 compared to the 2014?

7 A This is the budget in total, and this is -- yeah. This
8 is the budget in total for 2015. This is a very modest
9 increase. \$9 million is certainly a lot of money to nearly
10 everyone, but this \$9 million as compared to fiscal year 2014
11 budget is actually an increase of about one percent in the
12 total budget of the utility.

13 Q Well, let me ask you, now, that's a \$9 billion increase
14 compared to the fiscal 2014 budget; right?

15 A Um-hmm.

16 Q Now, you already testified and explained to the Court how
17 you had missed the -- the actual results of 2014 had missed
18 the budgeted by -- the budgeted results or revenues by over
19 \$40 million; right?

20 A Um-hmm.

21 Q Why are you showing an increase over the budget you
22 missed by 40 million in 2015?

23 A So this is a -- this is a revenue requirement increase,
24 so when the utility establishes a budget, we look first at
25 our current obligations, debt service and et cetera. We look

1 at any new CIP projects and any new financing expenses. We
2 look at a projection of our operating expenses, and we set a
3 revenue requirement. This is a revenue requirement.

4 Q Okay.

5 A And then we -- and then we propose and adopt rates in
6 order to deliver that revenue requirement.

7 MR. HAMILTON: Can we go to the next page of this
8 exhibit, which is 111, and can you blow up that top
9 paragraph?

10 BY MR. HAMILTON:

11 Q All right. So can you describe for the Court how the
12 rate was set in 2015?

13 A For 2015, again, we looked at those revenue requirements,
14 and we take into consideration what's changing in terms of
15 sale volumes. So while the net increase in new revenues
16 requirement might only be one percent, the fact that we also
17 have to make up for changes in volume, changes in estimates
18 of bad debt, et cetera, we establish this -- we establish
19 rates in accordance with that.

20 Q All right. So if we look at the first line of that full
21 paragraph --

22 A Um-hmm.

23 Q -- the fiscal year 2015 budget with respect to revenues
24 from supply services, how does that compare to the same
25 revenues that were projected in the 2014 budget?

1 A Again, repeat the question, please.

2 Q Sure.

3 A I want to make sure that we're -- that I'm absolutely
4 clear that you're asking about a revenue projection as
5 opposed to a sales volume. I want to make sure I distinguish
6 that.

7 Q Right; right. You had revenues for water supply services
8 projected in the 2014 budget; is that correct?

9 A That's correct.

10 Q What assumptions did the department make regarding
11 weather with respect to the projections of water -- of
12 revenue from water supply services in the 2014 budget?

13 A Very commonly practiced what we assumed was normal
14 weather conditions.

15 Q And what, in fact, happened in 2014?

16 A Another wet weather year.

17 Q Okay. So the revenues were higher or lower in 2014
18 compared to the budget?

19 A They would have been lower.

20 Q All right. What assumption did you make with respect to
21 weather in estimating what the revenue from water supply
22 services would be for fiscal year 2015?

23 A A normal weather year.

24 Q Okay. So if we compare the two budgets as opposed to
25 what actually happened, 2014 and 2015, in terms of revenue

1 from sale of water services, how does 2015's budget compare
2 to 2014?

3 A It would be -- it would -- I think the sales revenue --
4 I'd have to take a look at the budget, but I believe the
5 budgeted revenues would have been a little more -- the
6 budgeted revenues would have gone up because we were asking
7 for a four-percent increase in net revenue, but we would not
8 probably have included -- I want to make sure I understand
9 the question.

10 Q Well, let me ask you, do you see the line that says the
11 more conservative estimates of sales to customers in that
12 sentence that's highlighted?

13 A Correct. Primarily --

14 Q What does that refer to?

15 A Yeah. Primarily in the city one of the things that we
16 have continued to see within the City of Detroit is a decline
17 in overall sales, and that was adjusted for in the budget.

18 Q Okay. So while there was a decline in overall sales, the
19 board also approved an increase in rates for 2015; is that
20 right?

21 A Correct. And so here's an example of the net impact of
22 that. While the operating costs assignable to the City of
23 Detroit may have gone down, the rates would have gone up to
24 reflect both a decline in sales as well as an increase in bad
25 debt, and so the net rate increase to the city would have

1 been very different than the budgeted revenue requirement
2 change.

3 Q All right. Now, did the -- when did the Board of Water
4 Commissioners approve the fiscal year 2015 budget?

5 A I believe that -- I believe that was in January.

6 Q Okay. And after it was approved, did the department
7 continue to refine its financial projections for the next
8 five years?

9 A Certainly, particularly as we neared -- again, as we
10 neared the financing wanting to use the most current
11 information that we had available.

12 Q All right.

13 MR. HAMILTON: Can we go lower on the same page and
14 blow up the last paragraph at the bottom?

15 BY MR. HAMILTON:

16 Q Ms. McCormick, that paragraph and, in particular, the
17 third sentence talks about a review that the department did
18 from February through April of 2014. Are you familiar with
19 that review?

20 A Yes, I am.

21 Q Can you describe that for the Court?

22 A So in addition to just looking at the annual volumes,
23 what we did was a fairly sophisticated evaluation taking a
24 look at month-to-month comparisons during what we consider
25 normal dry weather months, so looking at that October through

1 April time frame when irrigation and other sorts of things
2 that can cause variation from year to year, you sort of take
3 those out and normalize to try to -- to try to take a look at
4 the true -- you know, a more accurate potential trend of
5 what's happening in sales. And as a result of that, we made
6 an adjustment in the sales volumes anticipated for the city.

7 Q This indicates it was a five-percent reduction for 2015;
8 is that right?

9 A Correct.

10 Q All right. And then that established the baseline, and
11 you had an additional -- for additional years projected out
12 additional reductions in volume; is that right?

13 A Correct.

14 Q Why is that?

15 A We look at outside agencies to try to confirm, you know,
16 these sort of long-term trends in communities generally
17 related to things like population trends, business trends,
18 and et cetera. I believe in this particular case, we took a
19 look at the SEMCOG data for population changes within the
20 City of Detroit.

21 Q If you look at the last line of that paragraph --

22 A Um-hmm.

23 Q -- there is an assumption regarding bad debt expense.
24 Can you describe your reasoning behind that assumption for
25 the Court?

1 A Yes. Now, the first thing I would say is this is a
2 operating statement that's prepared for both the rating
3 agencies as well as the investor community. We make it a
4 point to be as conservative as we can be. This is -- in our
5 long-term relationship with these agencies, if anything, we
6 want to make sure that we underpromise and overdeliver. And
7 while we have a number of initiatives to get at the bad debt
8 situation, we want to be very conservative with regards to
9 projections, and so we looked at about an 83-percent
10 collections rate, particularly for the city throughout this
11 five-year period.

12 Q Okay.

13 MR. HAMILTON: Can we go now to the next -- or to
14 page 114?

15 THE COURT: Excuse me. Before we move on, let's
16 take our morning recess at this time and reconvene at 10:30,
17 please.

18 MR. HAMILTON: Thank you, your Honor.

19 THE CLERK: All rise. Court is in recess.

20 (Recess at 10:14 a.m., until 10:30 a.m.)

21 THE CLERK: All rise. Court is back in session.

22 You may be seated.

23 THE COURT: You may proceed, sir.

24 MR. HAMILTON: Thank you, your Honor.

25 BY MR. HAMILTON:

1 Q Ms. McCormick, I have up on the screen now page 114 from
2 the offering statement of the water supply system bonds,
3 which is Exhibit 637, and this is the -- what you testified
4 as the most current financial projections for the water
5 supply system. And I want to ask you about the first line
6 here on operating revenue under existing rates. For year --
7 for fiscal year 2014, there's the phrase "unaudited
8 estimate," and it has the figure 347 -- about 348 million.
9 Do you see that?

10 A I do.

11 Q All right. That reflects the revenues -- the estimate of
12 the revenues that were actually received by the department;
13 is that right?

14 A That's correct.

15 Q So that reflects the bad weather year that we had for
16 fiscal year 2014; is that right?

17 A That's correct.

18 Q Okay.

19 A And actually, if -- when we say fiscal year '14,
20 remember, it includes the residual bad weather effect from
21 the prior summer as well as the wet weather effect from this
22 summer as well, so --

23 Q Okay. And then for the projections for fiscal years 2015
24 through '19, the operating revenues that are projected are
25 substantially higher than what you have for fiscal year 2014.

1 Do you see that?

2 A Yes.

3 Q And the biggest jump is in years 2015 and then it
4 gradually goes down in subsequent years. Do you see that?

5 A I do.

6 Q Why are the years 2015 through 2019 -- why are the
7 revenues projected to be so much higher than they were in
8 2014?

9 A Again, what you will see is each of the years is
10 projected on a normal weather year, but you will also see the
11 decline based on the anticipated continued trend line that we
12 see from the dry weather usage.

13 Q All right. So if we were to compare the 2014 number with
14 the 2015 number, one explanation that I believe you just said
15 is that you're assuming normal weather in 2015; is that
16 right?

17 A That's correct.

18 Q And was there a rate change in between 2014 and 2015?

19 A Yes, and this would have included that adjustment as
20 well.

21 Q Okay. So the difference between the 347 and the 379
22 figure in those two years is related to weather and the rate
23 change. Is that fair?

24 A That's correct.

25 Q Okay. All right.

1 MR. HAMILTON: Can we go to page 85 of this exhibit?
2 And can you blow up the top half of the -- the chart on the
3 top half of the page?

4 BY MR. HAMILTON:

5 Q All right. Ms. McCormick, this is again from the
6 official statement of August 27th for the water supply
7 system, Exhibit 637. What is this -- what does this table
8 show?

9 A This is the capital improvement program estimated
10 expenditure schedule.

11 Q All right. And is this the most current projections of
12 your capital improvement plans for the water supply system at
13 the time for the department?

14 A It is.

15 Q All right. And if you look in the bottom right-hand
16 corner, the last number for the total system for the six
17 years that are projected there, it's 713 million; is that
18 right?

19 A That's correct.

20 Q All right. I want to compare that number just generally
21 to what was in the city's projections attached to the
22 disclosure statement which we had as Exhibit M to the
23 disclosure statement.

24 MR. HAMILTON: Can we bring up Exhibit 178? It's
25 page 200 or 212. What is the -- I'm sorry. Exhibit 3. I'm

1 sorry. The disclosure statement. 200. And can you blow up
2 the top table, chart? Yeah. Actually, include the caption
3 if you could, a little higher. Thank you.

4 BY MR. HAMILTON:

5 Q All right. Ms. McCormick, this is from the -- what you
6 called the Conway MacKenzie projections that were attached to
7 the disclosure statement, and we talked about this earlier,
8 but this is just for the water fund. If you look at the
9 capital spending that the OHM estimates had for the same time
10 period that we just looked at in the official statement, 2014
11 through 2019, how do these numbers compare to what you have
12 in the official statement? Are they higher or lower? Do you
13 know?

14 A They're comparable. There are some adjustments, but they
15 are comparable.

16 Q Can you describe generally for the Court what the
17 adjustments were for the water system in the official
18 statement as compared to this document?

19 A Well, certainly for this document, again, the information
20 here would be a bit aged for the early years, and so there
21 would be adjustments there. And also for the -- as we were
22 preparing for the OS, one of the things that we wanted to
23 incorporate for the purposes of the investors in the bond
24 markets was the current forecasted impacts of the latest
25 information from our water master plan, and so that would

1 have impacted the last couple of years of the five-year
2 forecast.

3 Q And why would it have impacted? What changes did you
4 make with respect to capital improvements for water from --
5 during the last year?

6 A The five-year forecast acknowledges the fact that we have
7 five water treatment plants, but in order to serve the
8 projected requirements for the region, we can meet the
9 capacity requirements with three of those facilities, so
10 within the five-year forecast, it's envisioned that one of
11 those facilities could be removed from service. And so
12 capital expenditures for that facility would cease, but there
13 may be some capital investment required in transmission
14 systems in order to move the water more effectively, and so
15 those adjustments are reflected.

16 Q Okay. All right. I now want to ask you about the
17 current level of the services that are provided by the
18 Department of Water and Sewer. What is the department's
19 understanding of the current level of the quality of service
20 that the water system supplies to its customers?

21 A The water system has an excellent reputation for both
22 service as well as quality. It's award-winning. It's
23 complimented by our customer communities. I would say it was
24 an excellent level of service.

25 MR. HAMILTON: Can you bring up Exhibit 637, page

1 86? Can you highlight the second paragraph?

2 BY MR. HAMILTON:

3 Q All right. Now, Ms. McCormick, the very first sentence
4 of this paragraph appears to summarize what you just stated
5 to the Court; is that right?

6 A That's correct.

7 Q And this is the offering -- the official statement that
8 you provided to the bond markets in connection with the
9 refunding bonds; is that right?

10 A That's correct.

11 Q Did you engage an outside firm to assess the quality
12 of -- in part, the quality of the water supply service that's
13 being provided?

14 A We engaged a feasibility consultant.

15 Q And did you also engage an engineering advisor as well?

16 A We did.

17 Q All right.

18 MR. HAMILTON: Can you go to page 114 of this
19 exhibit, 637, which is the official statement for the water
20 refunding bond? That's not it, no. Page -- is that 637?
21 All right. So I have the wrong note. Excuse me, your Honor.
22 It's 126. All right. If you could blow up the first
23 paragraph under the system evaluation report.

24 BY MR. HAMILTON:

25 Q All right. Does this paragraph refer to the engineering

1 advisor that you just referred to?

2 A It is.

3 Q And so now we know what OHM stands for; is that right?

4 A That's correct.

5 Q Orchard Hiltz & McCliment?

6 A Um-hmm.

7 Q All right. And did their report -- how did their report
8 affect your assessment as to the quality of service that is
9 provided by the Department of Water Sewer with respect to
10 water?

11 A I would say that it confirmed my assessment.

12 MR. HAMILTON: Could you go down to the next
13 paragraph in this and highlight the first bullet?

14 BY MR. HAMILTON:

15 Q Is this the confirmation that you got from OHM that you
16 just referred to?

17 A Yes, it is.

18 Q Okay. Ms. McCormick, what is your understanding of the
19 quality of service that's provided by the sewer supply system
20 for the Department of Water and Sewer?

21 A I would say substantial progress has been made there as
22 well. Significant new investment has occurred at the
23 wastewater treatment plant, and, you know, from a system
24 performance standpoint during our most recent extremely large
25 storm, the system performed with outstanding performance, so

1 my assessment is that the system is really doing quite well.
2 Obviously it will need continued investment, but the system
3 is doing quite well. In the last two years the department
4 has actually earned the NACWA silver award for its
5 performance meeting water quality standards.

6 Q Would you say it's fair to say that the department is
7 providing an adequate level of sewer supply services to its
8 residents and customers?

9 A I believe that's a fair statement.

10 Q Did you get confirmation of that from the OHM advisors?

11 A That's my recollection.

12 MR. HAMILTON: Can you go to page 80 -- I'm sorry --
13 page 130 of Exhibit 636? Can you blow up the two paragraphs
14 under "system evaluation report," the paragraph in the first
15 bullet?

16 BY MR. HAMILTON:

17 Q Ms. McCormick, is this the confirmation that you just
18 referred to that you received from OHM regarding the sewer
19 services that are supplied by the department?

20 A Yes, it is.

21 Q And it's referring to three minor violations. Do you see
22 that?

23 A Yes.

24 Q Have you solved those problems?

25 A These types of three -- these three minor violations may

1 be based on an untimely performance of a piece of equipment,
2 and so while those types of things are pretty typical, they
3 are generally minor in nature, typical of all of wastewater
4 service providers, so this is not an atypical issue.

5 Q All right. Ms. McCormick, now I want to ask you a couple
6 questions about how the rates that the department charges for
7 its water and sewer services compare to comparable systems in
8 other cities.

9 A Okay.

10 Q Do you have an understanding as to where Detroit falls in
11 terms of comparing its rates to the rates of other systems in
12 comparable cities?

13 A We have looked -- we look every year as we adjust rates
14 as to our comparability within our service area. We also
15 look for comparability for other large utilities. Utilities
16 of our size typically have an economy of scale that gives us
17 an advantage, and so it's important to benchmark against
18 other similar large utilities. We do that as well as
19 utilities generally in the -- you know, in the general
20 regional area. And all our valuations over the course of the
21 last several years have indicated we run at or about the
22 average.

23 Q All right.

24 MR. HAMILTON: Can you bring up on Exhibit 637 page
25 104? And, again, this is the -- yeah. Actually, make it

1 105. Can you blow it up a little bit for me?

2 BY MR. HAMILTON:

3 Q This is, again, the official statement for the water
4 bonds, Ms. McCormick, and it's a table that was included in
5 the official statement. Can you describe what this table
6 shows?

7 A This is a collection of the data from the largest 50 U.S.
8 cities for the total for water and sewerage charges
9 experienced in those communities compared on a common use
10 basis.

11 Q And what does it show about Detroit compared to other
12 cities here?

13 A It shows us right in the middle of the pack.

14 Q Okay. And did you get a confirmation of where Detroit's
15 rate system falls compared to other cities from the Foster
16 Group in conjunction with their feasibility study?

17 A Yes, a very similar sort of analysis.

18 MR. HAMILTON: Can you go to page 125 of this
19 exhibit? Can you highlight the first bullet?

20 BY MR. HAMILTON:

21 Q Ms. McCormick, is this the summary of the confirmation
22 you received from the Foster Group on where your rates fall?

23 A It is.

24 Q All right.

25 MR. HAMILTON: Can we go to the second bullet there,

1 I believe?

2 BY MR. HAMILTON:

3 Q Ms. McCormick, I want to ask you what is your assessment
4 of the attractiveness of the water and sewer services
5 provided by your department to businesses in deciding where
6 to locate their business?

7 A For businesses that would be water use intense, I think
8 we provide a significant advantage. Not only are our rates
9 very attractive in terms of being comparable to other large
10 U.S. cities on average, but in addition to that, we have a
11 pretty significant advantage in that we have excess capacity,
12 which means if there are high-volume users that come into the
13 system, they will actually decrease our unit cost, which will
14 provide a cost advantage to them and all other customers of
15 the system. We don't have to make huge investments in order
16 to accommodate additional growth or additional large
17 customers.

18 Q Do you believe that the quality of water and sewer
19 services that the department provides is a positive or
20 negative factor to businesses in deciding where they might
21 locate -- whether to locate in the City of Detroit and
22 surrounding areas?

23 A I think positive.

24 Q Okay. All right. I now want to ask you some questions
25 about a series of demonstrative exhibits that were shown to

1 the Court by lawyers for Oakland County at the beginning of
2 trial, and the first one I want to ask you about is Exhibit
3 6111.

4 MR. HAMILTON: You don't have it? Okay. Well, we
5 have hard copies; right? If you can -- it should be in her
6 binder. Yeah. May I approach the witness, your Honor?

7 THE COURT: Yes. Oh, we have it.

8 MR. HAMILTON: Yep.

9 BY MR. HAMILTON:

10 Q It's now on the screen.

11 A That one is easier to look at.

12 Q All right. Do you have an understanding of what this
13 chart purports to show, Ms. McCormick?

14 A I do.

15 Q Can you explain it to the Court?

16 A Sure. What you see here is the annual capital
17 improvement expenditures for a number of prior years, 2004
18 through 2014, as well as the projected capital improvements
19 moving forward from there, and it shows both the budget as
20 well as the actual.

21 Q All right. And you'll see the dotted line that says 70
22 percent of POA. Do you see that?

23 A I do.

24 Q All right. Do you have an understanding as to why the
25 actual expenditures on capital improvements for the

1 department have historically been approximately 70 percent of
2 what was budgeted for the same time period?

3 A Um-hmm. Well, there's a couple of interesting things in
4 the way that this is laid out, but most typically when we do
5 our capital improvement projects, every capital improvement
6 project is going to carry some level of contingency. The
7 smallest amount of contingency on a project we carry is about
8 ten percent. Often it's more than that depending upon where
9 in the process we are in estimating, so about ten percent of
10 that variation is generally due to the fact that you don't
11 spend contingencies. The objective is not to spend
12 contingencies. They're there for things that you haven't
13 accounted for in your design process, so that's a piece of
14 this. The other part I can -- hopefully I won't insult any
15 engineers in the room, but generally in every system I have
16 worked in engineers have a little more appetite to be able to
17 accomplish things, and so it's very typical to see 15 percent
18 or so of what is actually planned to be expended be deferred
19 and kind of slide into the next year, and that kind of slides
20 out on the schedule. So typically when you look at capital
21 budgets, you will see fairly heavy loading in the first few
22 years, and then you'll see a tail-off. Again, engineers have
23 a big appetite for getting things done quickly, and then
24 often you see deferrals. It's not uncommon. When I worked
25 for the Lansing Board of Water and Light, we actually planned

1 in our expenditures for a 15-percent deferral from what was
2 budgeted. Those two factors alone could well account for
3 about 25 percent of this.

4 Q Do you believe it would be fair to conclude from this
5 chart that the department historically has had -- not had
6 sufficient revenue to pay for its planned capital
7 improvements?

8 A That's categorically untrue because the vast majority of
9 the capital, almost without exclusion, has been based on
10 capital financing, so bond financing for projects that are
11 projected several years into the future, so those funds are
12 already on hand. This is not an issue of funds on hand.
13 We're not revenue financing our capital. We're debt service
14 financing capital.

15 MR. HAMILTON: Can we bring up -- can you bring up
16 the next exhibit, 6112?

17 BY MR. HAMILTON:

18 Q This was another demonstrative from counsel for Oakland
19 County, Ms. McCormick, and I want to ask you about each one
20 of these bullets. The first bullet says that for the past 15
21 years sewer and water volume steadily declined, yet the POA
22 projects significantly increased billable water and sewer
23 sales in 2014 and 2015.

24 A Um-hmm.

25 Q Do you have an understanding as to why the Conway

1 MacKenzie projections of water and sewer sales were increased
2 compared to 2013 for years 2014 and 2015?

3 A Again, we didn't prepare those projections, but I do
4 believe that Conway MacKenzie used the department's
5 projections, which would have acknowledged from an actual to
6 a projected the uptick from wet weather to normal weather.

7 Q What was the weather like in 2013? Was it a bad year?

8 A It was very wet.

9 Q All right. And when the projections were made for the
10 disclosure statement, you didn't have the actual results from
11 2014 yet; is that right?

12 A That's correct.

13 Q So what was the assumption regarding weather in 2014-2015
14 in preparing those objections -- those projections?

15 A That they would have been normal weather.

16 Q Okay. All right. Second bullet, bad debt expense,
17 extraordinarily high and increasing, yet POA projects bad
18 debt expenses will decline. Do you have a view as to whether
19 it is appropriate to expect that the department will reduce
20 its bad debt expense going forward?

21 A Yes, I do.

22 Q What is it and why?

23 A Well, two. Again, one, I think it is reasonable to
24 expect that when the city emerges from bankruptcy it will pay
25 its bills, and so we would expect that to reduce the bad

1 debt. I mentioned that is one of the significant near term
2 bad debt experiences we're having, and similarly with the
3 schools. While they have struggled, they have been getting
4 better at making payment arrangements and getting closer to
5 erasing much of their bad debt as well. And the department
6 has continued to make more efforts in reducing bad debt as
7 well.

8 Q All right. Let's talk about the third bullet. Can you
9 explain to the Court what's been going on with the provision
10 of service to Flint and the surrounding county?

11 A Well, at the time that the Conway MacKenzie projections
12 were made, the department believed that Flint was going to be
13 on the system until the KWA pipeline was actually constructed
14 and in service, and instead Flint exited the system early, so
15 they did not stay on line until 2016. They actually came off
16 line when they put their plant in service with River Water
17 Supply much earlier. However, there's another factor here as
18 well, and that is the Flint contract actually provides
19 service to the City of Flint as well as to Genesee County,
20 and while Flint has exited the system, Genesee County remains
21 to be served, and they're each about 50 percent of the
22 revenues and volumes that are in that single contract, and so
23 Genesee does -- is still on line. Even if Genesee proceeds
24 with the construction of their water plant, 2016 is the
25 earliest exit date, but the department is actually still in

1 negotiations with Genesee for backup service, so, you know,
2 again, as you move forward in time, things are different than
3 they may have been at a particular point in time.

4 Q All right.

5 MR. HAMILTON: And can we go then to Exhibit 6113?

6 BY MR. HAMILTON:

7 Q All right. Ms. McCormick, this is another demonstrative
8 that counsel for Oakland County used in her opening
9 statement, and this purports to show a pretty big spike in
10 projected volume for water in 2014. Do you see that?

11 A I do.

12 Q All right. Do you have an understanding as to why that
13 spike was projected?

14 A Again, if you take a look at the actual volume, you will
15 see the big spike in 2011, which was closer to a normal
16 weather year. And if you were to take that even with a
17 slight downward trend line for decline in sales overall, 2014
18 is not an unreasonable estimate for a normal weather year
19 given the then current information.

20 Q And that current information -- at the time the
21 projections were made back in the fall 2013, the assumption
22 for the weather for fiscal year 2014 was what?

23 A Normal.

24 Q Normal or bad?

25 A Normal weather.

1 Q All right. So that would be comparable to what the
2 weather was like in the year 2011; is that right?

3 A That's correct.

4 Q Okay. So does this spike in the projection of volume
5 show any -- in your judgment, any attempt by the city to
6 manipulate or improperly state what projected revenues would
7 be?

8 A I don't believe so.

9 Q All right. Finally, I want to ask you, Ms. McCormick,
10 about --

11 THE COURT: Wait. Before we leave that slide --

12 MR. HAMILTON: Sure.

13 THE COURT: -- can you account for the difference
14 between the red and the green lines, the red being the plan
15 of adjustment projection and the green being your own
16 department's projection?

17 THE WITNESS: There is a -- I think this projection
18 is probably more current and does reflect the early loss of
19 Flint as compared to the earlier plan of adjustment
20 projection. And the 2014 green line would have been the
21 actual data point in 2014 after we actually experienced a wet
22 weather, but you will see the department for 2015 would have
23 done an uptick again noting the expectation that we would
24 have a normal weather year.

25 THE COURT: I got the sense from your answer that

1 you were speculating that that's what the difference is and
2 that you don't really know.

3 THE WITNESS: Well, certainly I would love to be
4 able to look at the back calculations to confirm that --

5 THE COURT: Let me ask you to --

6 THE WITNESS: -- but to the best of my knowledge,
7 I --

8 THE COURT: Let me ask you to do that perhaps over
9 lunch.

10 THE WITNESS: Yeah. Okay.

11 MR. HAMILTON: Well, your Honor, the problem is is
12 that this was an Oakland County demonstrative exhibit, so I
13 don't know what --

14 THE COURT: If the exhibit is inaccurate, then
15 that's possibly the explanation --

16 MR. HAMILTON: Okay.

17 THE COURT: -- but I want this investigated.

18 MR. HAMILTON: We will do that, your Honor.

19 BY MR. HAMILTON:

20 Q Finally, Ms. McCormick, I want to ask you about the 837
21 miles of transmission main pipes that was referenced by
22 Oakland County's lawyer during her opening statement.

23 MR. HAMILTON: Can we bring up Exhibit 178, page 13?
24 This is, I believe, the OHM report, your Honor. And can you
25 blow up the first -- Item B there?

1 BY MR. HAMILTON:

2 Q Ms. McCormick, can you explain for the Court what the
3 difference is between a transmission main pipe and a
4 distribution and service main pipe that's referenced here in
5 this paragraph?

6 A First of all, transmission main is a main that's
7 generally moving large volumes of water from location to
8 location, so in the DWSD system we have pipes that are 24
9 inch and larger in diameter, up to 96 inch in diameter, that
10 will move water from our treatment facilities out to local
11 communities, and then in each local community they're going
12 to have distribution mains. Those are mains that are
13 generally tapped to provide services into individual homes.
14 Transmission mains are generally not tapped for regular
15 service connections.

16 Q All right. So the distribution mains tap into the
17 transmission mains; is that correct?

18 A Correct.

19 Q All right. So the 3,100 miles of distribution and
20 service main that's referenced here, is that the distribution
21 and service mains that are owned and operated by the DWSD?

22 A Correct.

23 Q All right. Who owns the distribution and service mains
24 in the outside communities not in Detroit?

25 A The individual communities do.

1 Q All right. And who pays for the maintenance and service
2 of those distribution and service mains, DWSD or the
3 communities?

4 A No. The individual communities do.

5 Q All right. What are the distribution and service mains
6 that are owned by DWSD?

7 A Those are the ones within the City of Detroit.

8 Q Okay. And who pays for the maintenance and repair of
9 those distribution mains?

10 A DWSD does, and they're allocated in the City of Detroit
11 rates.

12 Q Okay. What are the department's plans for the
13 maintenance and replacement of its main -- transmission main
14 water pipes?

15 A I believe the CIP identifies a number of planned
16 transmission main projects and, in addition to that, carries
17 an allowance for those things that may occur that are not yet
18 planned.

19 Q All right. Are you generally familiar with the concept
20 of the useful life of transmission water pipe -- main water
21 pipes?

22 A I am.

23 Q Can you describe for the Court how that concept plays in
24 the department's plans for when, if ever, it plans to repair
25 or replace a transmission water pipe?

1 A Typically when we think about a useful life, this is
2 another way of saying for the utilities that use enterprise
3 fund accounting that we have -- that we're basically funding
4 depreciation, and so whenever we put an asset on the books,
5 we say it has a useful life of "X" number of years, and so we
6 fund through our rates the depreciation schedule. That's
7 what the useful life is generally used for. It's an
8 accounting practice. There is -- every type of water main
9 that goes into service is going to have its own
10 characteristics. We have a lot of different types of
11 materials. Each material is going to have a different
12 experience depending upon the soils that it's in, the quality
13 of the water, so while there is perhaps some relationship
14 between service life and when an asset might need
15 replacement, there's no direct -- there's no direct
16 connection, and so generally water mains are replaced based
17 on their actual experience in service, whether or not there's
18 creating a water quality problem, if there's internal
19 corrosion, whether or not you have service line breaks,
20 interruptions of service. Those are more generally the kinds
21 of experiences in performance characteristics that would
22 drive replacement of mains.

23 Q All right.

24 MR. HAMILTON: Can we go to page 25 of this exhibit,
25 the OHM report? All right. And I need you to blow up the

1 top half of this chart. There you go. No. That's not good.
2 Let's take -- let's just -- we don't need the numbers. Let's
3 just take the narrative here.

4 BY MR. HAMILTON:

5 Q All right. Ms. McCormick, Item D, the very top, large
6 diameter water mains, what are those?

7 A Those are transmission mains.

8 Q Okay. And what are the project -- what are these
9 projects under Item D, under 32, what do they refer to?

10 A These are transmission main improvement projects.

11 Q All right. And like, for instance, the first one, can
12 you describe that?

13 A Yes. This is a water main relocation on 24 Mile Road and
14 Dequindre. This is the installation of about five miles of
15 very large diameter transmission main.

16 Q All right. By five miles, we're -- you know, roughly
17 5,000 feet for a mile?

18 A Correct.

19 Q And so 25,000 feet, five miles; is that right?

20 A Correct.

21 Q All right. The next one, what's this one?

22 A This is, again, 42-inch water main in 24 Mile Road. This
23 is about seven miles of transmission main being installed.

24 Q All right. So that's five above and now seven miles.
25 What's the next one?

1 A This is 36-inch diameter water main in Telegraph. This
2 is about two miles.

3 Q All right. So now we got it up to 14 miles total for
4 those three projects?

5 A Yes.

6 Q That's going to be a little harder to read, but here we
7 go. All right. And then I think we're on D now. What's the
8 Wick station?

9 A Correct. Again, that's 48-inch main, about three miles.

10 Q So we're up to 17 miles?

11 A Correct.

12 Q All right. And then if we go -- the next one doesn't
13 have -- what is the E? What is that?

14 A So this is undetermined. As a part of Flint coming off
15 line on the 72-inch line that goes west from Imlay City, that
16 reduces the amount of flow on the line. In 2016 if Genesee
17 comes off the line, that will reduce the flow on the line
18 again. We think in terms of maintaining water quality,
19 difficult to do when you have extremely low flow on a very
20 large main, and we do have customers who will continue to
21 need to be served like Lapeer, Imlay City, and others, and so
22 what we are identifying here is that we need to develop a
23 project -- assuming those customers remain on the system, we
24 need to have a project ultimately to do something different
25 than serving them off that 72-inch main, so that's a yet to

1 be determined project.

2 Q Okay. And then the last one is Garland main. Can you
3 describe that?

4 A Again, this is rehabilitation of a section of
5 transmission main, and, again, this is 43,000 feet, so not
6 quite eight miles of main.

7 Q All right. So we add eight to the previous seventeen.
8 You're up to 25 miles.

9 A Correct.

10 Q All right.

11 MR. HAMILTON: And, again, can we go back to the
12 chart as a whole?

13 BY MR. HAMILTON:

14 Q And that shows that those 25 miles of replacements of
15 transmission mains are over the next three years; is that
16 right?

17 A That's correct.

18 Q Okay. All right.

19 MR. HAMILTON: Now, can we blow up Item 34, which
20 was -- yeah, that one.

21 BY MR. HAMILTON:

22 Q Can you describe for the Court what this allowance is
23 for?

24 A In the CIP in a variety of places what we have done is
25 made provision for adequate funding for what I would call

1 unknown circumstances, so this is an example in transmission
2 main replacement where we have an allowance because things
3 may happen. If we had a section of transmission main that
4 failed and we needed to replace some amount of it, we want to
5 make sure that we have funds and a plan on hand to do that,
6 and so this allowance allows us to have the flexibility to
7 address those kinds of situations.

8 Q Ms. McCormick, would it be fair to infer from this
9 particular item in the report that it's the department's plan
10 to replace only one to two miles of transmissions mains every
11 year for the foreseeable future?

12 A No, of course not. The planned projects are really what
13 is identified for defined projects that we're planning and
14 engineering. The one to two miles is just -- that's a
15 contingency, again, for something that we might not have
16 recognized, and if it happens, we're prepared to address it,
17 but the vast majority of what we're doing is in the planned
18 projects.

19 Q So like for the next three years, you're doing over 25
20 miles of replacement of transmission mains; is that right?

21 A That's correct.

22 Q Right. That's a little over eight miles a year; right?

23 A Right. And those are both replacements as well as some
24 additions, and so some of what we do is parallel something
25 that's existing so we increase reliability. We might not

1 necessarily abandon what's there. As long as it's there, we
2 may interconnect and have some flexibility, but, yes, a
3 significant investment in transmission.

4 Q All right. All right. Ms. McCormick, are the projects
5 that are contemplated by the department's capital improvement
6 programs sufficient to enable the department to continue to
7 provide adequate levels of water and sewer services to its
8 customers for the foreseeable future?

9 A We believe so. Much of what you see in our CIP has not
10 only been reviewed by our staff but by independent engineers,
11 and this is something that we share with our customer
12 communities as well every year. They have an opportunity to
13 review the CIP. If they believe that there are areas of the
14 system that are servicing them for which they think
15 investment is needed, they share that with us, and that's
16 considered in the development of the capital improvement
17 plan, so, yes, I believe so.

18 Q Does the department believe there's any material risk of
19 a failure of the DWSD infrastructure that would prevent it
20 from providing adequate levels of water and sewer services to
21 its customers?

22 A Like any system, I think we will have -- we will most
23 certainly have failures. We will have water main breaks. We
24 will have sanitary sewer failures in very specific areas
25 impacting customers, but a failure of the system overall and

1 its ability to serve customers, no, I don't believe so.

2 Q Do the department's internal financial projections show
3 that the department will have access to sufficient funds to
4 pay for the capital improvement programs that it has
5 determined it needs for the foreseeable future?

6 A Yes, we believe so.

7 MR. HAMILTON: I have no further questions, your
8 Honor.

9 MR. SOTO: No questions.

10 THE COURT: Any cross-examination?

11 MR. BARNOWSKI: No questions, your Honor.

12 THE COURT: All right. So let me ask you over the
13 lunch break perhaps working with counsel to get my little
14 question answered, and we'll recall you at that time.

15 THE WITNESS: Okay.

16 THE COURT: And we'll do this testimony like first
17 thing after lunch --

18 THE WITNESS: Okay.

19 THE COURT: -- so you can get on your way. All
20 right. So you're excused for now.

21 THE WITNESS: Thank you.

22 (Witness excused at 11:10 a.m.)

23 THE COURT: As a technical matter, counsel, is there
24 any objection to admitting into evidence the slides from the
25 Oakland County opening statement that the witness was asked

1 about not for the truth of any of it but only so that the
2 record is complete in terms of what the witness was examined
3 on?

4 MR. SOTO: No, your Honor. As a demonstrative, we
5 have no problem.

6 MR. HAMILTON: That's fine, your Honor.

7 THE COURT: All right. What were those numbers
8 again, please?

9 MR. HAMILTON: Yeah. It's 6111, 6112, and I
10 believe --

11 MR. SOTO: 6113.

12 MR. HAMILTON: -- 61113.

13 THE COURT: 6113. Okay. For that limited --

14 MR. HAMILTON: 11, 12, 13.

15 THE COURT: Yeah. For that limited purpose, the
16 Court will admit those documents.

17 (Oakland County Exhibits 6111, 6112, 6113 received at
18 11:11 a.m.)

19 MR. MILLER: Good morning, your Honor. Evan Miller
20 for the City of Detroit, Jones Day. May I approach with some
21 sets of exhibits?

22 THE COURT: Okay.

23 MR. MILLER: The city would like to call as its next
24 witness Suzanne Taranto.

25 THE COURT: Okay. Please raise your right hand.

1 SUZANNE TARANTO, CITY'S WITNESS, SWORN

2 THE COURT: All right. Please sit down. Counsel,
3 for planning purposes, I want to advise you that we're going
4 to break for lunch a little before 11:40.

5 MR. MILLER: Thank you.

6 DIRECT EXAMINATION

7 BY MR. MILLER:

8 Q Please state your full name for the record.

9 A Suzanne Taranto.

10 Q And where do you live, Ms. Taranto?

11 A In Ridgewood, New Jersey.

12 Q And could you please describe your educational
13 background?

14 A Yes. I have a bachelor's of science in biology and
15 mathematics from Stonehill College.

16 Q And when did you receive that degree?

17 A In 1983.

18 Q And what is your profession?

19 A I'm an actuary.

20 Q And where are you employed?

21 A I'm employed with Milliman, Inc.

22 Q And how long have you been employed at Milliman?

23 A Since 2005.

24 Q And where were you employed before Milliman?

25 A I started my career with the Wyatt Company, now known as

1 Towers Watson, as a pension analyst.

2 Q And how long were you employed at Towers?

3 A Sixteen years.

4 Q And after leaving Towers, where did you -- where were you
5 employed?

6 A I was the director of benefits for Ingersoll Rand.

7 Q And can you please describe to the Court Ingersoll Rand
8 Corporation and what it does?

9 A Ingersoll Rand is a multi-national at that point Fortune
10 250 company that is in a number of different industries.

11 Q And how long were you employed at Ingersoll?

12 A About three years.

13 Q And after leaving Ingersoll, what was your next place of
14 employment?

15 A I worked for AXA Equitable Life Insurance Company.

16 Q And what was your job title at AXA?

17 A Senior vice president of compensation and benefits.

18 Q And how long were you employed at AXA?

19 A About three years.

20 Q And after AXA?

21 A Milliman.

22 Q What is your title at Milliman?

23 A I'm a principal and consulting actuary.

24 Q And in what office of Milliman do you practice?

25 A The New York office.

1 Q And do you have any designations in the actuarial field?

2 A Yes. I'm an enrolled actuary and a member of the
3 American Academy of Actuaries.

4 Q And do you have a specialty within the actuarial field?

5 A Yes, I do.

6 Q And what is that specialty?

7 A I am trained as a pension actuary, although currently I
8 practice as a health actuary.

9 Q And what portion of your practice is devoted to health
10 benefits consulting?

11 A A hundred percent.

12 Q And what kinds of consulting services do you provide in
13 connection with health benefits issues?

14 A We consult with employers and other health plans on the
15 design and financing of their health benefits.

16 Q And do you prepare for your clients actuarial liability
17 valuation reports on retiree health benefit programs?

18 A Yes, I do.

19 Q And for how many years have you been preparing actuarial
20 liability valuation reports respecting retiree health
21 benefits?

22 A My first retiree medical valuation was performed in 1987,
23 so I've been doing it for awhile.

24 Q And approximately how many actuarial liability valuation
25 reports for retiree health programs do you prepare annually?

1 A My team prepares about a hundred reports a year. I'm
2 involved with a little over half of them.

3 Q Okay. And how many of these reports are in connection
4 with governmental retiree health programs?

5 A It varies year to year. About a dozen or so.

6 Q Okay. And just for the record, by "governmental," I
7 meant retiree health programs sponsored by governments for
8 their employees.

9 A Correct. Understood.

10 Q And do you have any leadership roles at Milliman?

11 A Yes. I lead the health practice for the New York region
12 employee benefits practice.

13 Q And how many individuals does Milliman employ in the
14 health practice in the New York region?

15 A About a dozen.

16 Q And how many clients does the New York region's employer
17 health practice group serve?

18 A About a hundred or so.

19 Q Have you published in connection with health benefits
20 issues?

21 A Yes, I have.

22 Q And can you describe for the Court some of those
23 publications?

24 A My recent publications have been focused on the impact of
25 the Affordable Care Act on employer plans, including

1 compliance and issues on private exchanges.

2 Q And where do you publish?

3 A Generally in Milliman's available publications.

4 Q Have you published outside of Milliman generally
5 available publications?

6 A No, not really.

7 Q Are you familiar with the concept known as a VEBA --

8 A Yes, I am.

9 Q -- or VEBA trust?

10 A Yes, I am.

11 Q And what is a VEBA?

12 A A VEBA is a voluntary employees beneficiary association.
13 It's a trust that's described in Internal Revenue Code
14 Section 501(c)(9).

15 Q And have you been involved in any transactions or matters
16 in which a company transferred its retiree health obligations
17 to a VEBA facility or trust?

18 A Yes, I have.

19 Q And can you describe some of those?

20 A Yes. I have been involved with the United Auto Workers
21 in a number of VEBA transactions, including the VEBAs that
22 hold the retirees of GM, Ford, and Chrysler, Mack Trucks,
23 Daimler Trucks North America, and a few others.

24 Q And do you currently serve as the actuary for any retiree
25 health VEBA trusts?

1 A Yes. About a dozen.

2 Q And what's the nature of the services that you provide
3 for such trusts as an actuary?

4 A We provide funding projections, design consultation, and
5 other support in delivering benefits under the trust.

6 Q And can you identify for the Court some of the larger
7 VEBA trusts for which you are currently providing actuarial
8 consulting services?

9 A Yes. Besides the UAW, GM, Ford, and Chrysler VEBAs, I
10 also provide consulting for Dana Corp., UAW VEBA, as well as
11 Mack Trucks, Daimler Trucks North America, and so on.

12 Q And what is the approximate value of the assets in these
13 trusts for which you serve as consulting actuary?

14 A The GM, Ford, and Chrysler combined assets are, I
15 believe, just in excess of 60 billion.

16 Q And have you previously been retained to provide expert
17 opinion on retiree health matters in litigation?

18 A I have.

19 Q And approximately how many cases have you been retained
20 to provide expert testimony in connection with retiree health
21 matters?

22 A About eight.

23 Q Okay. Did any of them involve a bankruptcy?

24 A Yes.

25 Q Which bankruptcy matters were you retained as an expert

1 in?

2 A Dana Corporation.

3 Q And who retained you in Dana?

4 A I was jointly retained in that engagement by the auto
5 workers and the steelworkers.

6 Q And on what matters did you offer opinions in that case?

7 A In that case, I offered opinions as to the size, the
8 magnitude of the retiree medical obligations reported by Dana
9 as well as some commentary on the designs -- proposed designs
10 that Dana had been proposing to the auto workers and
11 steelworkers.

12 Q And were you qualified as an expert in the Dana
13 bankruptcy?

14 A I was.

15 Q And did you, indeed, testify in the Dana bankruptcy?

16 A I did.

17 Q Have you been deposed in any other cases in which you've
18 been retained to provide expert testimony?

19 A Yes. I was recently deposed in a matter, United
20 Steelworkers versus Cliffs Natural Resources. That was last
21 month.

22 Q And can you please briefly summarize for the Court other
23 cases in which you've been retained to provide expert
24 opinions but were not deposed or did not testify at trial?

25 A Generally, I've provided expert opinions in the VEBA

1 negotiations that we referenced earlier.

2 Q Okay. And did any of these cases have any connection to
3 Detroit?

4 A Yes. I believe a few of them were heard right here in
5 this court, GM, Ford, and Chrysler.

6 Q And those would be the cases involving the United Auto
7 Workers and the VEBAs for the big three auto companies?

8 A Yes.

9 MR. MILLER: Your Honor, the city moves to have Ms.
10 Taranto qualified as an expert on matters of actuarial
11 science with respect to retiree health benefit matters.

12 MR. SOTO: No objection, your Honor.

13 THE COURT: You may proceed.

14 MR. MILLER: Okay.

15 BY MR. MILLER:

16 Q Ms. Taranto, I'd like to begin this part of the
17 examination by discussing some basic concepts regarding
18 retiree health accounting and valuation. Are you familiar
19 with the term OPEB, O-P-E-B?

20 A Yes.

21 Q And what does OPEB mean?

22 A OPEB stands for other post-employment benefits, which
23 generally means anything other than a pension benefit.

24 Q Okay. And can you describe for the Court some of the
25 forms of benefits that would fall into the category of OPEB

1 benefits?

2 A Sure. That would include retiree medical, retiree life
3 insurance, long-term disability benefits, and other benefits
4 payable to retirees.

5 Q And how do employers customarily pay for OPEB benefits?

6 A Employers can pay for OPEB benefits in one of two ways.
7 For the most part, employers pay on a pay-as-you-go basis out
8 of operating assets, although employers can pre-fund some
9 retiree medical benefit obligations.

10 Q Okay. You said a moment ago out of operating assets.
11 Did you mean operating cash?

12 A Operating cash, yes.

13 Q Okay. And do cities and municipalities, do they
14 typically, in your experience, pay for OPEB benefits on a
15 cash basis?

16 A More often than not.

17 Q Are employers required to set aside money to pay for
18 future OPEB benefits?

19 A No, they're not.

20 Q And is this in contrast to the rules that we heard about
21 yesterday and on Monday governing employers paying for
22 pension benefits?

23 A Yes, it is.

24 MR. SOTO: Your Honor, foundation. I don't know if
25 she was here yesterday and Monday.

1 BY MR. MILLER:

2 Q Were you in court yesterday?

3 A Yes, I was.

4 Q Okay. And based on the testimony you heard yesterday,
5 the allowance of employers to pay for OPEB benefits with
6 cash, is that in contrast to the rules governing how
7 employers pay for pension benefits?

8 A Yes. There's no prefunding requirements.

9 Q Are you familiar with the term EPBO?

10 A Yes.

11 Q And what does EPBO mean?

12 A EPBO stands for expected post-retirement benefit
13 obligation, which represents the present value of all
14 benefits expected to be paid over time from a retiree medical
15 plan.

16 Q And does an EPBO measurement typically include the
17 present value of retiree health benefits for currently active
18 employees as well as retirees?

19 A Yes, it does.

20 Q And can you briefly summarize how an actuary performs an
21 EPBO calculation?

22 A Yes, I can. The first step in performing an EPBO
23 calculation is to determine the value of the benefits being
24 provided from the plan. The next step is to project that
25 value into the future in all future years typically using

1 medical inflation. The next step would be to determine how
2 many individuals will be around to receive those benefits
3 multiplying the number of people times the value of benefits
4 to develop a payout stream. That payout stream is then
5 discounted back to today dollars to determine the present
6 value of the benefit promise.

7 Q Thank you. Okay. I now want to turn to Milliman's work
8 for the City of Detroit in connection with retiree health
9 benefits. Did there come a time when Milliman was engaged by
10 the City of Detroit in connection with retiree health
11 benefits matters?

12 A Yes.

13 Q And when was that?

14 A That was in June of 2012.

15 Q And who approached Milliman on behalf of the City of
16 Detroit?

17 A Jack Martin, who is the CFO.

18 Q Okay. And who at Milliman did Mr. Martin approach?

19 A He approached me.

20 Q Did you know Mr. Martin at that time?

21 A Yes. Mr. Martin serves as a trustee on four of the
22 retiree medical VEBAs that I work on.

23 Q And what was the primary purpose of your engagement by
24 the city in 2012?

25 A The primary purpose was for us to assist the city in

1 first understanding the obligations of their plans and -- of
2 the retiree medical plan and, second, to help them design a
3 program or plan that would be affordable.

4 Q And since that initial engagement, have you performed a
5 variety of projects respecting the city's retiree health
6 benefits programs?

7 A Yes, I have.

8 Q And as a consequence of those efforts, have you gained an
9 in-depth understanding of the health benefits arrangements
10 that the city historically provided to its retirees?

11 A Yes, I have.

12 Q What was the first task that you undertook following Jack
13 Martin's engagement on behalf of the city of Milliman?

14 A Our first task was to understand the plans that the city
15 was currently offering to its retirees.

16 Q Okay. And how did you go about obtaining the information
17 respecting the existing plans and programs?

18 A We requested information from the city and from the
19 city's advisors, including such things as retiree enrollment
20 guides, communications to retirees, contracts with medical
21 providers, and collective bargaining agreements.

22 Q Okay. And why did you request collective bargaining
23 agreements from the city?

24 A Because the benefits were subject to collective
25 bargaining, and some of the variations among the programs

1 were outlined in collective bargaining agreements.

2 Q So did you review the terms relating to retiree health
3 obligations that may have been set forth in these bargaining
4 agreements?

5 A I did or my team did, yes.

6 Q Can you summarize for the Court what you learned about
7 the key features of the retiree health plans that were
8 sponsored by the City of Detroit in 2012?

9 A Based on our investigations, we found the city was
10 offering 24 plans, 24 different programs, 10 of which applied
11 to Medicare-eligible retirees, and 14 applied to pre-
12 Medicare-eligible retirees or non-Medicare-eligible.

13 Q And what determines Medicare eligibility?

14 A For individuals who pay into the Medicare system,
15 typically attaining age 65 and signing up.

16 Q And the ten options that were offered to Medicare-
17 eligible retirees, how did they interact with the federal
18 government's Medicare program?

19 A Those programs supplemented Medicare; that is, they
20 provided benefits to wrap around what Medicare would
21 otherwise provide.

22 Q And did the city's costs to provide such options -- did
23 they include the cost of Medicare coverage?

24 A No. No, it did not.

25 Q Okay. Approximately how many retirees were receiving

1 health benefits from the city in 2012?

2 A About 17,000.

3 Q And how many of that number were Medicare-eligible?

4 A About 11,000.

5 Q And did the city at that time also provide retiree health
6 coverage to the spouses and dependents of the retirees?

7 A Yes, it did.

8 Q Okay. And approximately how many spouses did the city
9 provide coverage to in 2012?

10 A About 8,500 spouses and dependents.

11 Q Collectively?

12 A Collectively, yes.

13 Q Did those figures, the roughly 17,000 retirees in
14 coverage and 8,500 dependents and spouses in coverage, did
15 they materially change as of the time of the Chapter 9
16 filing?

17 A No, they hadn't.

18 Q Did the city prefund any of its retiree health
19 obligations?

20 A No, it did not.

21 Q Historically, how did the city go about paying for these
22 retiree health benefits?

23 A Operating cash.

24 Q And what is your understanding of how the city pays for
25 retiree health benefits today?

1 A Operating cash.

2 Q So after educating yourself about the benefit design of
3 the Detroit retiree health programs, what was the next major
4 step that you undertook in your engagement for the city?

5 A Our next step was to calculate the retiree medical
6 liability, and so in order to do that, we first replicated
7 the existing actuarial valuation that the city had of its
8 benefit plans.

9 Q And as of 2011 and 2012, who served as the healthcare
10 actuary for the city?

11 A Gabriel, Roeder, Smith.

12 Q And Gabriel, Roeder, Smith at the time was also the
13 actuary for the two Retirement Systems?

14 A That's my understanding.

15 Q And at the time that you began this audit, what was the
16 date of Gabriel, Roeder's last completed retiree health
17 valuation for the city?

18 A June 30th, 2011.

19 Q And was that, indeed, the actuarial valuation report that
20 you conducted your audit upon?

21 A Yes.

22 Q Did that valuation report contain a so-called EPBO
23 liability number?

24 A Yes, it did.

25 MR. MILLER: Can you flip on the screen Exhibit 518?

1 BY MR. MILLER:

2 Q Ms. Taranto, can you go about describing for the Court
3 the process by which you undertook and completed that
4 replication audit?

5 A Yes. In order to complete a replication of another
6 actuary's work, we need to use -- we need to first determine
7 that we have the same data and processes that the actuary
8 used. Our first step was to request the data file that
9 Gabriel, Roeder, Smith used in calculating the -- in
10 performing the valuation. By "data file" I mean the
11 individual participant data information for current and
12 future retirees of the city that was used in their valuation.
13 The second step was to determine the assumptions and methods
14 that were used to project future benefits. Assumptions and
15 methods included demographic assumptions as well as other
16 assumptions as to the cost of the benefit plan. We coded our
17 valuation system to perform those calculations using that
18 data and those assumptions and generated liabilities, which
19 we compared to Gabriel, Roeder, Smith.

20 Q So you, in fact, did receive census data from the city in
21 connection with this audit?

22 A We received the Gabriel, Roeder, Smith data, yes.

23 Q Yeah. And did you review and check that data before
24 inputting it into your system?

25 A We validate it to make sure that the counts were

1 consistent with the data reported by Gabriel, Roeder, Smith
2 in their documents.

3 Q And in connection with the assumptions that you used in
4 making this calculation, did Milliman develop its own
5 assumptions?

6 A Not for the replication. We used Gabriel, Roeder,
7 Smith's assumptions as they stated.

8 Q And in connection with the benefit rules and provisions
9 of the retiree health program, how did you go about
10 determining what those provisions were?

11 A We used the information summarized in Gabriel, Roeder,
12 Smith's report.

13 Q And so once you had assembled the data and reviewed it
14 and identified the assumptions and benefit plan provisions,
15 did you, indeed, employ a software system to calculate the
16 liability amount?

17 A Yes, we did.

18 Q Okay. And what was that system?

19 A That system was the VAL 2000 system, which is the
20 calculation engine for Milliman's liabilities.

21 Q Okay. And that is the software system that Mr. Bowen had
22 testified to earlier this week?

23 A Yes.

24 Q Okay. And did you employ the VAL 2000 system in a manner
25 consistent with the manner testified to by Mr. Bowen?

1 A Yes.

2 Q Okay.

3 MR. MILLER: Can we blow up the chart on that page?

4 BY MR. MILLER:

5 Q And was your team at Milliman successful in replicating
6 the Gabriel, Roeder results?

7 A Yes, we were.

8 Q And can you discuss that chart and explain the numbers on
9 it?

10 A Yes. Working from top to bottom, this chart compares the
11 EPBO calculated by Gabriel, Roeder, Smith as of June 30th,
12 2011, separately for the General and Police and Fire Systems,
13 with the Milliman calculations of the same EPBO liabilities.
14 Our calculations were within less than one-percent different
15 of what Gabriel, Roeder, Smith had calculated, and so
16 Gabriel, Roeder, Smith's total liability on an EPBO basis was
17 7.182 billion. Our liability was 7.117 billion.

18 Q And of the \$7.117 billion number that you calculated,
19 approximately how much of that liability figure was
20 attributed to then current retirees of the city?

21 A About 3.5 billion.

22 Q And what discount rate did you utilize in preparing this
23 audit?

24 A We used Gabriel, Roeder, Smith's assumption. Their
25 discount rate in this case was four percent.

1 Q Did you prepare City Exhibit 518?

2 A Yes.

3 Q Okay. And let's go back to the full page of the exhibit,
4 page Number 1, and that exhibit is dated June 29th, 2013.

5 And did you sign this letter?

6 A Yes, I did.

7 Q And does this letter set forth the results of your
8 replication audit?

9 A Yes, it does.

10 Q And does it accurately describe those results?

11 A Yes, it does.

12 MR. MILLER: Your Honor, the city moves for the
13 admission of 518 into evidence.

14 MR. SOTO: No objection, your Honor.

15 THE COURT: All right. It is admitted.

16 (City Exhibit 518 received at 11:38 a.m.)

17 THE COURT: And we will pause now for lunch and
18 reconvene, please, at 1:45.

19 THE CLERK: All rise. Court is in recess.

20 (Recess at 11:38 a.m., until 1:45 p.m.)

21 THE CLERK: All rise. Court is back in session.

22 You may be seated. Recalling Case Number 13-53846, City of
23 Detroit, Michigan.

24 THE COURT: Sir.

25 MR. HAMILTON: Good afternoon, your Honor. Robert

1 Hamilton of Jones Day.

2 SUE F. MCCORMICK, CITY'S WITNESS, PREVIOUSLY SWORN

3 DIRECT EXAMINATION (CONTINUING)

4 BY MR. HAMILTON:

5 Q Ms. McCormick, during the lunch break, did you have the
6 opportunity to review some financial data that is reflected
7 in the Oakland County exhibit that we were discussing before
8 the lunch break?

9 A I did.

10 Q All right.

11 MR. HAMILTON: Can I ask you to bring up City
12 Exhibit 3, the Exhibit M to the disclosure statement, which
13 is the Conway MacKenzie projections and, in particular, page
14 682 of that? I'm sorry. 687. Can't even read my own
15 writing. And could you blow up just the first part about
16 volumes? Yeah. All right.

17 BY MR. HAMILTON:

18 Q And you see the first assumption listed in the Conway
19 projections, Ms. McCormick? Can you describe to the Court
20 what that is?

21 A I do. It indicates that in the Conway MacKenzie
22 projections, the first fiscal years, both fiscal year '14 and
23 '15, were based DWSD's budget estimates. Beyond that point,
24 it indicates that there's a volume decline through 2023 based
25 on the SEMCOG population decline.

1 Q All right. And the 2014 and 2015 budget estimates are
2 the ones that your department provided to Conway MacKenzie
3 when they were preparing this document; is that right?

4 A That's correct.

5 MR. HAMILTON: Could we go to page 711 of this
6 document? And could you blow up just the water system the
7 first three years and go all the way down to the footnote?
8 All right.

9 BY MR. HAMILTON:

10 Q All right. This is the water system, and we're focusing
11 just on retail, Ms. McCormick. What is the -- what was the
12 actual amount of water volume for retail in the water system
13 in 2013?

14 A In 2013 the retail sales would have been 3,660,327.

15 Q So approximately 3.7?

16 A That's correct.

17 Q Okay. And then 2014 the retail water system estimate was
18 what?

19 A Four million units of sale.

20 Q And there's a -- next to '14 there's a "B" up there with
21 a footnote one. Do you know what the "B" stands for?

22 A I don't know what the "B" stands for.

23 Q If you look at the footnote down before --

24 A I do know -- I do know that in 2014 the -- this indicates
25 the water wholesale budgeted volumes have been reduced by two

1 percent.

2 Q So that --

3 A That doesn't apply to retail.

4 Q Is the four million what was in your fiscal year 2014
5 budget at that time?

6 A Yes, it was.

7 Q Okay. All right. And then if you go back, the 2015, the
8 retail budgeted volume was what?

9 A 3,775,000.

10 Q Okay. So now if we go back to Oakland County Exhibit
11 6113, all right, and if you look at the blue line, the
12 actual, all right, if you look at 2013 where all the lines
13 seem to intersect, the blue and the dark red one right there,
14 that's about what given the column on the left? 367?

15 A That would be the -- that would be a good approximation.
16 If you held a ruler across there, that's a good
17 approximation.

18 Q Okay. And then if you look at where they have what this
19 chart calls the POA projection for, 2014 what is the retail
20 volume on that chart?

21 A About four million units of sale.

22 Q Which was in the fiscal year 2014 budget?

23 A Correct.

24 Q Okay. And then if you look at the 2015 number for the
25 POA projection, on the scale on this chart what is it about?

1 A That's about the three million 775.

2 Q Which was in your fiscal year 2015 budget at the time?

3 A That's correct.

4 Q Okay. All right. So now let's look at Exhibit 367 -- I
5 mean 637 -- excuse me -- and, in particular, page 234. Now,
6 just to set the record, Ms. McCormick, Exhibit 637 is the
7 official statement from August 27th for the water refunding
8 bonds. Do you recall that?

9 A That's correct.

10 Q Okay. And this is a document that's from that official
11 statement, and if we blow up the table -- all right. What
12 does this table reflect?

13 A This table reflects the water sales that are projected
14 most recently for the official statement.

15 Q Okay. And if you look at 2014, again, the column for
16 2014 is the actual results, not the budget; is that right?

17 A That's correct.

18 Q All right. So what does it show for water retail down at
19 the bottom under 2014? What's the volume?

20 A 3,400,000 units of sale.

21 Q Okay. And if you look at 2015, what's the volume for
22 retail water?

23 A 3,500,000.

24 Q Okay. So now if we go back to Oakland Exhibit 6113, all
25 right, and now we look at the very first data point for

1 what's called the DWSD projection for 2014, can you estimate
2 approximately where that is on the scale on the left-hand
3 side?

4 A About three million four.

5 Q Which was what's in the official statement of a few weeks
6 ago?

7 A That's correct.

8 Q All right. And if we look at for 2015, it goes up a
9 little bit approximately to what?

10 A A little over three million five.

11 Q Which is commensurate with the figure in the official
12 statement?

13 A That's correct.

14 Q All right. So now if we compare in 2015 --

15 A Um-hmm.

16 Q -- the number that was in the POA projection, which I
17 think you said was around 3.775, to what you just said is in
18 the most current DWSD projection, which was I think you said
19 3.5 --

20 A Correct.

21 Q What's the difference there between what Conway MacKenzie
22 had projected back in the fall of 2013 and what the
23 department is now projecting as its volume as of August 27th
24 of this year?

25 A So one of the things that the department was projecting

1 that was incorporated in the Conway MacKenzie -- in those
2 first two years of Conway MacKenzie, we were actually
3 projecting at that particular time that the Detroit water
4 volumes were going to plateau. A year later we had another
5 year's worth of data, and in the review of that data, we went
6 back and did a pretty significant review of the seasonal
7 volumes both during the nonpeak season as well as during the
8 peak season. Two things we discovered. One is that the
9 peaking factor in Detroit has just about evaporated, not
10 quite, but there's very little summer irrigation, and so
11 there's a lot less weather variability. And so the size of
12 the adjustment to go to normal weather in that initial
13 forecast you'll see is much smaller, the uptick from the wet
14 weather conditions.

15 The other thing we saw is that there was additional
16 decline in the normal weather kinds of situations, and so we
17 actually made about a five-percent adjustment in the overall
18 volume in the first year, and then we also did adjust the
19 long-term projection to be a continuing decline of about 2.5
20 percent for the first five years and then beyond that point
21 matching the SEMCOG projections.

22 MR. HAMILTON: Can you bring up page 111 of 637 --
23 of City Exhibit 637, which, again, is the official statement
24 for the water refunding bonds? And can you highlight the
25 bottom paragraph for me or expand it?

1 BY MR. HAMILTON:

2 Q All right. Does this paragraph describe that review and
3 your decision to reduce volumes by five percent in fiscal
4 year 2015 from what was originally budgeted?

5 A It does.

6 Q Okay.

7 MR. HAMILTON: Does that answer your questions, your
8 Honor, on this chart?

9 THE COURT: Well, so let's just close the loop on
10 this. Does this five-percent reduction that you decided was
11 appropriate account for the difference between the two
12 numbers mathematically?

13 THE WITNESS: Yes, I believe it does.

14 THE COURT: Okay. All right. Are you done?

15 MR. HAMILTON: I am done, your Honor.

16 THE COURT: All right. Let me just ask a few
17 questions of you. Did you testify earlier that all of the
18 department's capital improvement projects -- well, let me
19 state it backwards -- that none of the city's capital
20 improvement projects are paid for or financed by revenues and
21 that it is all through borrowings?

22 THE WITNESS: If I used the term "all," I would say
23 substantively. There may be two or three percent in any
24 given year, but quite substantively through borrowing.

25 THE COURT: Okay. I've had a lot of numbers thrown

1 at me here this morning in your testimony especially, and so
2 my head is swimming a little bit on this question, so let me
3 just ask you to give your best estimate at this point in time
4 as you sit here. How much in capital improvement projects do
5 you foresee for the next ten years?

6 THE WITNESS: That's a good question. We foresee on
7 average about a hundred million dollars a year on each side
8 of the system on average over the course of the next ten
9 years.

10 THE COURT: So that's two billion?

11 THE WITNESS: That's about that; right.

12 THE COURT: So your testimony is that over the next
13 ten years the department will have borrowed approximately \$2
14 billion?

15 THE WITNESS: No. And the difference is the current
16 Board of Commissioners -- one of the things that we are doing
17 in our rates, while we are constrained in operating expenses,
18 the projection for four-percent increases in revenue is
19 intended to grow us into revenue-financed capital slightly,
20 so we will reduce the amount of borrowing that we do in order
21 to finance the capital program.

22 THE COURT: So what is your best estimate then as to
23 how much the department will be required to borrow for
24 capital improvement projects over the next ten years?

25 THE WITNESS: Well, we would -- our projections

1 indicate that we will on the sewer side be constraining
2 borrowing after the next few years, so the vast majority of
3 that would be revenue-financed capital. On the water side,
4 our projections indicate that we will likely borrow for some
5 period of time before we are able to have substantial revenue
6 financing.

7 THE COURT: Um-hmm.

8 THE WITNESS: I know I didn't give you a number.

9 THE COURT: What are the risks as you assess them
10 that that goal will be met?

11 THE WITNESS: Some of it has to do with our cost of
12 borrowing. The higher our cost of borrowing, the more that
13 our revenue will be used for debt service payments as opposed
14 to being able to revenue finance capital. That has been a
15 significant concern of us, particularly as we've gone through
16 the bankruptcy process. Do we have risk that there may be
17 further declines in volume? We have projections, projections
18 that we think are consistent with the data and recognize the
19 national trends. In our marketing plans, we hope to be able
20 to offset some of what we think will be the natural trend of
21 loss by projected new market opportunities, so there are
22 risks certainly.

23 THE COURT: Did you also testify, in effect, that
24 it's the department's policy to replace the larger -- I think
25 you called them transmission lines or transmission mains.

1 What's the technology --

2 THE WITNESS: Transmission mains.

3 THE COURT: -- terminology? Transmission mains.

4 THE WITNESS: Um-hmm.

5 THE COURT: When they appear to need it; is that
6 right?

7 THE WITNESS: That's correct.

8 THE COURT: So there's not a plan to replace these
9 lines on a periodic basis just because of age, for example?

10 THE WITNESS: No. That would be at the highest
11 level of capital investment that any system could bear is if
12 you replaced it according to some type of arbitrary schedule.

13 THE COURT: Um-hmm.

14 THE WITNESS: We do leak detection. We've started
15 doing helium detection, various ways of being able to check
16 the status of underground infrastructure so that we have
17 advance information, but certainly not according to some
18 arbitrary schedule.

19 THE COURT: And is that consistent with the
20 generally accepted practice among water systems of this
21 approximate size?

22 THE WITNESS: Yes, it is.

23 THE COURT: What is your assessment of what impact
24 the new Great Lakes Water Authority would have on the
25 department's operations, especially as they relate to

1 continued feasibility to provide water service for our area?

2 THE WITNESS: I generally see it as a positive.
3 Certainly it -- I believe that perhaps, if not immediately,
4 in the relatively short term it would allay many of our
5 concerns with regards to access to affordable capital. I
6 also believe, based on the current memorandum of
7 understanding, the ability to help support some of the
8 infrastructure renewals that are required in the City of
9 Detroit without that being a direct impact on the customers
10 will help support affordability, so I think there are some
11 very positive signs there. One of the things that we have
12 focused on is the ability to operate both effectively and
13 efficiently. We have been just by the nature of these
14 transactions, unfortunately, impeded in some of our progress,
15 so we hope to move faster, and we think that the authority
16 governance will assist us with that, so we think that will
17 help reduce costs.

18 THE COURT: Um-hmm. And now the most general
19 question I can pose to you, what challenges do you foresee
20 your department facing over the next ten years in fulfilling
21 its mission?

22 THE WITNESS: Unknowns, the things we don't know.
23 One of the challenges that I think, particularly as we move
24 to an authority, there has been a long-term relationship
25 between DWSD and its customers that's been very one on one,

1 City of Detroit and a conversation on the other side. As we
2 move to a regional authority, we have to change that to be a
3 collaborative conversation and think more in terms of
4 regional planning terms. That will be a big shift just in
5 communities working with one another for the benefit of the
6 system. That will be a huge challenge, one that I think will
7 be worth the returns, but it will be a big change in the way
8 that it operates. I think one of the challenges for the
9 department, as I understand the MOU, is that portion of the
10 system that is retained by the City of Detroit and operating
11 in some aspects of its operations independent of the
12 authority and sort of standing up the ability for that,
13 again, to be supported by the city. That's a challenge.
14 Every system does that, and they do it successfully. I would
15 have hope and faith that the city can do that as well, but it
16 is a challenge to make that separation effective,
17 particularly for the city as it's separated from a larger
18 entity.

19 We will continue to see changes in consumer
20 behaviors. I think we have to be smart about watching that.
21 In our most recent master planning efforts, we have tried to
22 establish benchmark criteria that we will monitor on an
23 ongoing basis so that when you plan, you plan based on a
24 point in time, and you look out for some period. Typically
25 utilities renew these plans every five to ten years, but a

1 lot can change in five or ten years and so just continuing to
2 take a look at the plan and making sure that it remains
3 relevant. A number of things that I have seen at DWSD as we
4 have begun work on certain things we weren't watching as a
5 system what was changing, and we got down the road and made
6 some investment that ultimately didn't result in a project,
7 and we had to write those -- we had to write those dollars
8 off. We want to be much smarter about that and make sure
9 that everything we're doing in planning stays relevant for
10 the current time. And I think those are some of the biggest
11 challenges.

12 THE COURT: What will be your role and the
13 department's role in meeting those challenges? And I want
14 you to focus on the first two that you identified.

15 THE WITNESS: Um-hmm. Over the course of the next
16 200 days or so, if the authority moves forward -- and we'll
17 know that in fairly short order -- we've already begun to lay
18 out the challenge in just getting all of the questions first
19 asked and then answered. There are a series of activities
20 that are going to have to occur to consider impacts on
21 permits, impacts on systems, impacts on people, financial
22 planning, so there is a significant amount of work to be done
23 in 200 days. I'm already working with folks to lay out those
24 project plans so that we can get that work done, so I will
25 certainly participate in that.

1 THE COURT: Was that answer intended to address the
2 issue of shifting the culture of the department from a one-
3 on-one relationship to a multi-party discussion?

4 THE WITNESS: In the multi-party discussions, we
5 have -- we've begun to talk about that with our customers
6 over the course, frankly, of the last year or so as the
7 authority conversations have been in various forms --

8 THE COURT: Um-hmm.

9 THE WITNESS: -- in conversation, and I was
10 fortunate at the time of being hired to have had the
11 perspective both from the city governance as well as from my
12 board of the recognition of this system's operation as a
13 regional entity and regional service provider. So much of
14 the conversations I've had with customers and customer
15 communities for the last two and a half years has been to try
16 to begin to change the thinking. We have established a
17 number of things, including bringing members from various of
18 our customer communities into actual project teams, into
19 selection of key personnel, into some of the major decisions
20 we've made on biosolids. We've had customer community
21 representatives right alongside the DWSD staff, so I think
22 we've made inroads into that. I think many of our customer
23 communities are encouraged about that and will willingly come
24 to participate. Thinking between them, some of that has
25 happened by the nature of the way we've changed our

1 contracts, encouraging communities in various geographical
2 areas in the system to begin to do planning amongst three or
3 four communities, and we need to expand and leverage that.
4 That will be a huge advantage to the system.

5 THE COURT: This could perhaps be what you were
6 talking about, but I'm going to speak perhaps a little more
7 bluntly.

8 THE WITNESS: Sure.

9 THE COURT: Is it fair to say, in your estimation,
10 that certain customers, communities, and others carried a
11 certain amount of distrust or lack of confidence or
12 skepticism about the department's ability to carry out its
13 mission in the most efficient way?

14 THE WITNESS: Not trying to be too blunt, there is
15 an undeniable history. There have been challenges from some
16 of the customer communities. Interestingly enough, as
17 I've -- since I wasn't a part of that history, as I've talked
18 with some of the community representatives who have engaged
19 in interactions with DWSD over the years, much of that from
20 their perspective, even their challenges to some of what was
21 happening in the department, was what they say as defending
22 the department from the city, which is an interesting
23 perspective that there was a challenge as to the --

24 THE COURT: What is meant by -- what is meant by
25 that?

1 THE WITNESS: There were certain instances where the
2 city, for instance, allocated costs to DWSD for services
3 provided, which is very appropriate, but there were certain
4 costs allocated to the department that the customer
5 believed -- customers believed were not equitable.

6 THE COURT: Um-hmm.

7 THE WITNESS: One of those was a 800-megahertz radio
8 transaction where the majority of the benefit of the system
9 was to police and fire, but the majority of costs were
10 disproportionately allocated to DWSD and, of course, then
11 borne by the customers of the water and sewer system. And
12 there are handful of those types of instances that I hear
13 over and over again as some of the stories where the
14 customers challenged those sorts of things in defense of
15 DWSD. They didn't attribute it to the DWSD staff or the DWSD
16 operation as much as to the influence of DWSD being a
17 department of the city.

18 THE COURT: And so in your estimation, to what
19 extent do those concerns still exist and do you feel need to
20 continue to be addressed?

21 THE WITNESS: Judge Cox's order went a very long way
22 to giving our customers of the system comfort that many of
23 the things that they had observed in the past would not or
24 could not occur in the future.

25 THE COURT: Um-hmm.

1 THE WITNESS: I get a lot of very positive feedback
2 about the governance board that we have that has established
3 integrity. I get a lot of positive feedback about how
4 encouraged they are about the department's demonstrated
5 integrity and the transparency in our operations, sharing
6 information, inviting folks interdecision-making. There's
7 a -- there is a much greater interaction today in open space,
8 if you will, between the department and our customers, so is
9 it tenuous? It has a short history, three years since the
10 new board was put in place, two and a half years since the
11 new department administration has been there but,
12 nonetheless, substantial progress I think and trust. To some
13 degree I think the discussion about the regional authority is
14 welcome in terms of creating additional arm's length
15 separation from the city and a governance board that is
16 predominantly suburban community.

17 THE COURT: Um-hmm. It sounds like you support the
18 creation of this authority and think it's in the best
19 interest of the department?

20 THE WITNESS: I do. I think it is actually for the
21 city and for the system a very good solution. It assists the
22 city in its capital needs. It assists the region by setting
23 up this larger affordability structure for customers who have
24 payment issues throughout the system, which I think is
25 wonderful. And I do think that the regional authority will

1 allow greater efficiency, greater collaborative planning,
2 greater market access and development, which will help
3 everybody keep costs down, so, yes, I do think it's a good
4 thing.

5 THE COURT: All right. That's all the questions I
6 have. Anything further from counsel?

7 MR. HAMILTON: No, your Honor.

8 THE COURT: Thank you for your testimony and for
9 coming today.

10 THE WITNESS: Thank you.

11 (Witness excused at 2:13 p.m.)

12 MR. MILLER: Good afternoon, your Honor. Evan
13 Miller, Jones Day, for the City of Detroit.

14 THE COURT: You may proceed.

15 MR. MILLER: Thank you.

16 SUZANNE TARANTO, CITY'S WITNESS, PREVIOUSLY SWORN

17 DIRECT EXAMINATION (CONTINUING)

18 BY MR. MILLER:

19 Q Well, Ms. Taranto, when we broke for lunch, I think you
20 had just wrapped up a discussion of the replication audit of
21 Gabriel, Roeder, Smith's retiree health work, and
22 approximately when was that replication audit work completed?

23 A In June of 2013.

24 Q And after having completed that work, what was your next
25 significant assignment from the city?

1 A Our next assignment was to update the valuation to be
2 current with respect to the benefit plan that was being
3 offered by the city so that we may begin to look at
4 alternative designs for the city in the long term.

5 Q Okay. Were there, in fact, changes made to the benefit
6 design between 2011, '12, and 2013?

7 A Yes, there were. Some of the plans that we talked about
8 had changed in terms of copayments and other cost-sharing
9 features. As well there were changes in some of the
10 providers, including notably prescription drugs.

11 Q So essentially you were tasked to conduct another
12 valuation?

13 A Yes, to update.

14 Q And can you walk the Court through the steps that
15 Milliman undertook in connection with this liability
16 valuation?

17 A Yes. The first step was to gather updated participant
18 data. We relied on two sources for that. The first was the
19 July 1, 2012, pension active census that we received -- that
20 Milliman received from Gabriel, Roeder, Smith. The second
21 was to solicit from the city itself a file of retirees and
22 the medical programs that they participated in, which we did
23 in February of 2013.

24 Q And did you take any actions to check and evaluate the
25 quality of this additional data?

1 A Yes. We put it through our standard data checking
2 procedures. We compared it to the prior data to understand
3 what had changed since the July 1, '11, valuation and
4 otherwise did a series of checks to ensure that there were no
5 major data discrepancies.

6 Q Okay. And how did you go about evaluating the benefit
7 provisions and rules that govern the 2013 version of the
8 program?

9 A We used both -- we used a combination of updated premium
10 amounts for the fully insured plans and developed new per
11 capita baseline rates for the self-insured plans reflecting
12 claim experience and adjustments for changes in plan design
13 that we calculated using Milliman systems that are designed
14 to provide a value or an adjustment for a plan design change.

15 Q Okay. Why don't you explain to the Court the difference
16 between a self-insured program and a fully insured program
17 and how they played into the overall framework of the retiree
18 health program as it stood in 2013?

19 A Sure. The city engaged with insurance companies and
20 carriers in two different ways with respect to receiving
21 healthcare benefits. For some plans they purchased a fully
22 insured plan; that is, a single premium set by the insurance
23 company which covered the entire cost of that package of
24 benefits. For other providers, the providers paid claims on
25 behalf of the city as well as handling the administration,

1 and so those programs were known as self-insured programs.

2 Q And in both instances the city paid for these programs
3 out of what source of funds?

4 A Operating cash.

5 Q And in connection with this liability audit, what
6 assumptions did you apply in performing the task?

7 A We used a combination of Gabriel, Roeder, Smith
8 assumptions from the July '11 -- or the June '11 valuation
9 and some Milliman assumptions for other elements of the
10 calculation.

11 Q And what were the important assumptions in which you
12 applied Milliman-determined assumptions?

13 A One of the things that we did was use Milliman's models
14 for calculating medical trend or future medical inflation.
15 Milliman has a proprietary model that it uses. It's based on
16 a Society of Actuaries study, and we feel that is -- that's
17 our standard for calculating liabilities under retiree
18 medical plans.

19 Q And is a medical trend assumption an important assumption
20 in developing a present value of liability for retiree health
21 benefits?

22 A Absolutely, yes.

23 Q Aside from medical trend, what are the other key
24 assumptions that are needed in undertaking a present value
25 calculation of retiree health liability?

1 A One of the other important assumptions was discount rate,
2 and as we talked earlier, we did not have a pool of assets
3 which -- with investment returns that we could use to develop
4 a discount rate, so we turned to a bond matching approach
5 that is commonly used for developing long-term liability
6 discount rates.

7 Q And what is that bond matching approach that you used in
8 connection with this liability analysis?

9 A A bond matching approach pairs corporate bonds with
10 future benefit payments, so the process includes matching a
11 bond yield rate at each future year with the expected
12 payments and discounting it back to today to develop a
13 present value.

14 Q And was there a particular bond yield curve that you used
15 in undertaking this analysis?

16 A Yes. Typically we use the Citigroup yield curve.

17 Q Okay. And is the Citi yield curve a readily available
18 published source of duration matched bonds?

19 A Yes. The Citigroup publishes on a monthly basis, and
20 it's fairly commonly used.

21 Q Okay. And in applying the Citigroup yield curve, did you
22 arrive at a single discount rate number that you then used
23 for purposes of the valuation?

24 A Yes. Typically we do this discounting based on different
25 payments and then develop a single discount rate that gets

1 you to the same liability.

2 Q Okay. And is the Citigroup yield curve a commonly used
3 methodology for determining a long-term obligation?

4 A Yes. Under financial statement accounting standards, the
5 bond matching methodology is the recommended methodology for
6 determining discount rates, so it's commonly used.

7 Q And that's primarily in the private sector?

8 A Correct.

9 Q Were there any other key assumptions that went into the
10 liability analysis determination?

11 A No. That was it.

12 MR. MILLER: Can we put on the screen City Exhibit
13 525? And let's go to page 5. And let's blow up the
14 paragraph and table right under "B," overview of results.

15 BY MR. MILLER:

16 Q Ms. Taranto, does the information on this paragraph
17 include the result of the liability analysis that you
18 conducted and we were just discussing?

19 A Yes, it does.

20 Q And which line contains the numerical result of that
21 analysis?

22 A The line called -- starting baseline plan.

23 MR. MILLER: Please highlight that line.

24 BY MR. MILLER:

25 Q And, in fact, what was your EPBO valuation result for the

1 liabilities that you analyzed?

2 A Six billion 522.3 million.

3 Q And approximately how much of that 6.522 billion was
4 attributable to then current retirees?

5 A About 3.2 billion.

6 Q And you may recall in the prior testimony before lunch
7 when we were talking about the replication audit, I think you
8 testified that the percentage of that liability that was
9 attributable to then current retirees was approximately \$3.5
10 billion. Do you recall that testimony?

11 A The liability -- the prior liability was 3.5, yes.

12 Q Yes. And what was the primary reason for the difference
13 between the \$3.5 billion number that you had arrived at in
14 connection with the replication audit and this \$3.2 billion
15 number for current retiree liabilities relating to this
16 audit?

17 A The changes in the plan design that we talked about,
18 primarily increased retiree cost sharing both from
19 contributions and copayments and deductibles.

20 Q And these changes were made between 2011 and '12, on the
21 one hand, and 2013 on the other?

22 A Yes.

23 Q Let's go back to the first page of this letter. Did you,
24 in fact, prepare this letter dated, I believe, October --
25 what is it -- 30th, 2013?

1 A Yes.

2 Q And does this letter set forth the results of the
3 valuation analysis that you just described?

4 A Yes, it does.

5 Q Does it accurately describe those results?

6 A Yes, it does.

7 Q And in undertaking the calculations set forth in City
8 Exhibit 525, did you employ the VAL 2000 software tool?

9 A We did.

10 Q And did you employ it in a manner -- in a similar manner
11 testified to by Mr. Bowen earlier this week?

12 A We did.

13 MR. MILLER: The city moves for the admission of
14 Exhibit 525 into evidence.

15 MR. SOTO: Your Honor, I don't know what the
16 privileged material redacted line is on there, but there
17 doesn't appear to be anything redacted in the one I have, and
18 I don't know if it's just mislabeled or if I'm just missing
19 what's redacted or --

20 MR. MILLER: The only item that is redacted is
21 literally a label that says "attorney-client privilege."

22 MR. SOTO: In which case we have no objection.

23 THE COURT: All right. Thank you.

24 MR. MILLER: Thank you.

25 THE COURT: The document is admitted.

1 (City Exhibit 525 received at 2:25 p.m.)

2 BY MR. MILLER:

3 Q Ms. Taranto, did the city amend its retiree health
4 program following the filing of the Chapter 9 petition?

5 A Yes, it did.

6 Q And when did that revised program take effect?

7 A Generally March 1st, 2014.

8 Q You said generally in March of 2014. Why did you say
9 that?

10 A There were some other additional changes that happened, I
11 think, in May of 2014, some minor changes.

12 Q And did you participate in the development of this
13 program that took effect in March of this year?

14 A I did.

15 Q And in what manner did you participate?

16 A I helped the city with both determination of the value of
17 benefits that they could afford for the year as well as
18 negotiating appropriate designs and insurance contracts in
19 the case of the Medicare plan that would deliver those
20 benefits.

21 Q And was the benefit design of this program the subject of
22 litigation?

23 A Yes, it was.

24 Q And with whom was that litigation?

25 A The Retiree Committee.

1 Q The Retiree Committee and the city?

2 A Yes.

3 Q Can you briefly summarize for the Court the retiree
4 health plan program that took effect in March of this year?

5 A Yes. The retiree program that took effect in March of
6 this year had two components. For the Medicare-eligible
7 participants, Medicare-eligible participants received a
8 Medicare supplemental plan that was either available through
9 Blue Cross or HAP for the retiree and the retiree's Medicare-
10 eligible spouse. With respect to the non-Medicare-eligible
11 participants, those participants received stipends in various
12 amounts depending on their status from the city.

13 Q And can you please summarize for the Court the
14 modifications that were made to that program several months
15 after its implementation in March?

16 A The adjustments in May were generally related to stipend
17 amounts, cash received by different groups.

18 Q In connection with the development of this 2014 program,
19 did the city ask you to model its cash flow obligations
20 respecting retiree health benefits?

21 A Yes, it did.

22 Q And what particular retiree health benefit plans were you
23 asked to run cash flow models in connection with?

24 A We were asked to model both the current plan and a number
25 of alternative plan cash flows.

1 MR. MILLER: Can you queue up City Exhibit 484,
2 please, and turn to page 7? I think it's entitled Exhibit 1.
3 Thank you.

4 BY MR. MILLER:

5 Q Ms. Taranto, can you please walk the Court through the
6 chart and tables and please elucidate the particular numbers
7 respecting the city's cash flow obligations?

8 A Yes, I can. The information on this page provides
9 expected future cash payments from the retiree medical plans
10 separately for non-Medicare, which are on the left, and
11 Medicare-eligible retirees. We provide for each future year
12 the total cost of the plan, the expected portion to be paid
13 from retirees, direct contributions from retirees, and the
14 net amount that's payable from the city. So, for example, in
15 2014, for non-Medicare-eligible retirees, the net expected
16 city cost was 83.7 million, and for Medicare-eligible
17 retirees, the net expected city cost was 80.79 million.

18 Q And it says right near the top under City of -- under
19 Exhibit 1, City of Detroit Baseline Plan. Can you please
20 advise the Court what was meant by the baseline plan?

21 A The baseline plan was the plan in effect in 2013 that we
22 provided the valuation we just talked about as of July 1st,
23 2012.

24 Q Okay. And so this cash flow model, for example,
25 indicates that under the baseline plan, the plan as it

1 existed in 2013, the expected cost for the city would have
2 been roughly \$164 million?

3 A That's correct.

4 Q Okay.

5 MR. MILLER: Can you highlight in bold the data
6 running from fiscal year 2014 through fiscal year 2023?

7 BY MR. MILLER:

8 Q So, Ms. Taranto, this highlighted material would show the
9 net city costs for the 2013 program over a ten-year period;
10 is that right?

11 A That's correct.

12 Q And, in fact, did you do the simple math in connection
13 with that cash obligation?

14 A Yes, I did.

15 Q Yes. And can you advise the Court what the math
16 indicated?

17 A \$2.05 billion over ten years.

18 Q That's 2.05 billion in --

19 A Billion.

20 Q -- a cash obligation?

21 A In cash obligation, in cash payouts over ten years.

22 Q For what program again?

23 A This is the baseline, the 2013 -- excuse me -- city
24 program.

25 Q Thank you. And did you prepare these cash flow

1 projections using the VAL 2000 model?

2 A Yes, we did.

3 Q And did you prepare these cash flow projections
4 consistent with application of the model that's been
5 previously testified to?

6 A Yes, we did.

7 MR. MILLER: Your Honor, the city moves that City
8 Exhibit 484 be admitted into evidence.

9 MR. SOTO: No objection, your Honor, assuming it's
10 the same label issue we had.

11 MR. MILLER: Yeah. And, indeed, it is.

12 THE COURT: The \$2 billion that you testified to,
13 that's for both non-Medicare and Medicare?

14 THE WITNESS: Yes. That's combined.

15 THE COURT: And that's just the total dollar payout,
16 not present value?

17 THE WITNESS: No discounts; correct.

18 THE COURT: All right. The document --

19 MR. MILLER: That is the cash obligation.

20 THE COURT: Yeah. The document is admitted.

21 (City Exhibit 484 received at 2:32 p.m.)

22 BY MR. MILLER:

23 Q In connection with the retiree health liability, the
24 present value calculations that you have been previously
25 testifying to, the ones made in 2012 and 2013, those were so-

1 called EPBO calculations?

2 A Yes, they were.

3 Q And, thus, what population did they include?

4 A They included both current and future retirees of the
5 city.

6 Q Did there come a time when the city asked you to model
7 the present value of the city's retiree health benefits
8 program focusing only on current retirees?

9 A Yes.

10 Q Okay. And when was that?

11 A That was in April of '14.

12 Q Did the city at that time advise you of the intended
13 purpose for those calculations?

14 A Yes. The city advised us that these calculations were
15 settlement calculations.

16 Q Okay. And in your experience, what's a retiree health
17 settlement calculation?

18 A A settlement generally is an irrevocable one-time action
19 that -- transaction that relieves a plan sponsor of future
20 obligations to provide those benefits.

21 Q Is a -- does the word "settlement" have a meaning in
22 accounting that's widely understood?

23 A Yes. Financial statement 88 describe -- and the
24 accounting statement that applies to post-retirement medical
25 plans, FAS 106, now with new names, 715-60 -- sorry --

1 describes a settlement as a one-time -- as a specific --
2 specifically describes a settlement as a one-time event that
3 irrevocably removes liability or responsibility of a plan
4 from a plan sponsor.

5 Q Thank you. In undertaking the retiree only actuarial
6 present value modeling this past April, did you use the
7 benefit design from 2013 or the benefit design from 2011-12?

8 A The 2013. Excuse me.

9 Q And did you make the decision to use that design in the
10 calculation?

11 A The city advised us to do that.

12 Q And in undertaking this modeling, did you take another
13 look at the benefit provisions in 2013 to make sure that they
14 were accurate as far as Milliman was concerned?

15 A They were accurate as far as Milliman was concerned.

16 Q And what census data did you use to conduct these
17 valuations in April?

18 A We used the census data that was the basis of the retiree
19 component of the baseline valuation that we just talked
20 about.

21 Q And what discount rate did you employ in making this
22 analysis?

23 A We were provided with a series of discount rates from the
24 city to use.

25 Q So you were directed to use a set of discount rates?

1 A Yes.

2 Q In conducting this sensitivity analysis, did you change
3 any of the demographic assumptions respecting retiree
4 benefits in comparison to those assumptions you had been
5 previously using in your efforts?

6 A Yes, we did.

7 Q And can you advise the Court of those changes in
8 assumptions?

9 A Yes. There were two changes in assumptions that we made
10 for this calculation. The first was to assume that retirees
11 of the city who currently were electing to receive dental and
12 vision benefits but not medical benefits elected to begin
13 receiving medical benefits immediately.

14 Q So let me stop you right there. So there was an
15 assumption that you made about people who had been electing
16 only dental and vision coverage from the city?

17 A Correct.

18 Q And what was the assumption that you made in connection
19 with this effort?

20 A For purposes of this calculation, we assumed that those
21 participants would begin to receive, that would come back
22 into the plan to receive medical as well as dental and vision
23 benefits.

24 Q Were there any other changes in assumptions that you --

25 A Yes. There was another group of retirees who were not --

1 who were eligible for coverage but who were not electing any
2 benefits from the city's plan, and we assumed that those
3 participants for this exercise would also elect to come back
4 into the plan and receive benefits.

5 Q And did anybody instruct you to make those changes in
6 assumptions?

7 A Yes. The city did.

8 Q Did you have -- in connection with these changes in
9 assumptions, did you have any understanding as to whether
10 retirees who were eligible for health insurance but had
11 chosen not to elect and enroll, whether they could opt back
12 into the program?

13 A Yes. It was our understanding that retirees could elect
14 to participate or not on an annual basis in the plan.

15 Q And did the 2013 benefit design impose any barriers or
16 costs on retirees who had opted out to opt back in?

17 A Not that we were aware of.

18 Q Let's focus for a moment on the retirees who were
19 receiving only dental and vision coverage. How many retirees
20 and dependents were receiving only dental and vision coverage
21 from the city?

22 A There were about a thousand retirees and about 440
23 dependents.

24 Q And how did you arrive at the number?

25 A Those were the individuals in our data. We had them in

1 the previous valuation but only electing dental and vision
2 coverage.

3 Q And why were they previously in the system?

4 A Because they're receiving benefits from the plan.

5 Q And how many retirees and dependents were eligible for
6 retiree health but not receiving retiree health benefits in
7 2013?

8 A We included 1,829 of those retirees.

9 Q Did you include any spouses?

10 A Not -- no, I don't think so.

11 Q Did you make any assumptions as it might relate to
12 spouse -- the extent to which these retirees who had opted
13 out might have spouses who were eligible?

14 A No. We didn't assume any spouses.

15 Q What was the -- generally speaking, what was the impact
16 on the liability numbers that you obtained from these changes
17 to the assumptions about the retiree population and coverage?

18 A Generally, based on the range of discount rates that we
19 used in the calculation, between 400 and \$500 million of
20 additional liability.

21 Q Is it reasonable to include in a retiree health liability
22 calculation the value of medical coverage for retirees who
23 are participating in the program but only electing to
24 participate to a limited degree such as electing only dental
25 and vision coverage?

1 A In a settlement calculation, it's reasonable to assume
2 that people will come back in. This calculation provided the
3 city with the outer boundary of that liability. It assumed a
4 hundred percent came in.

5 Q And, similarly, is it reasonable to include in a retiree
6 health liability present value calculation of medical
7 coverage for retirees those retirees who are eligible but are
8 not, in fact, participating in the program at the time of
9 measurement?

10 A It's reasonable to assume that people would come back.
11 Again, as an outer boundary, our calculation included all of
12 them.

13 MR. MILLER: Can you put on the screen City Exhibit
14 456? And let's turn to page 6, and let's blow up the chart
15 and table at the top of page 6.

16 BY MR. MILLER:

17 Q Ms. Taranto, we'll get into this chart in a little bit
18 more detail in a moment, but I just for now would like you to
19 summarize this chart and advise the Court about what it
20 represents.

21 A Okay. The column on the left represents the discount
22 rate that was used to generate the liability, and the figures
23 on the right under "present value of benefits" represent the
24 liability in billions of dollars associated with that
25 discount rate of the retiree only obligation.

1 Q And these discount rates that are on the left-hand side,
2 are these the discount rates that the city directed you to
3 use in the calculation?

4 A Yes, they are.

5 Q And just to clarify the record, the results on the right-
6 hand side, those are in billions?

7 A Billions with a "B," yep.

8 Q And in running the calculations using these directed
9 discount rates, did you, indeed, employ the VAL 2000 system?

10 A Yes, we did.

11 Q Okay. And after assembling the census data and the
12 benefit provisions and inputting the assumptions, did you use
13 that system in the manner previously testified to?

14 A Yes.

15 MR. MILLER: Your Honor, the city moves to have this
16 chart from Ms. Taranto's expert report as a stand-alone
17 exhibit, and I believe it would be City Exhibit 708.

18 MR. SOTO: No objection, your Honor.

19 THE COURT: It is admitted.

20 (City Exhibit 708 received at 2:43 p.m.)

21 BY MR. MILLER:

22 Q Okay. Ms. Taranto, focusing again on this chart, can you
23 please describe the discount rates that are on the bottom of
24 the table on the left, the ones that begin 3.47 percent and
25 below that 2.60 percent?

1 A Yes. The discount rates on the bottom of -- the bottom
2 two lines represent the PBGC termination -- PBGC interest
3 rates for terminating plans at two different points in time.

4 Q And can you explain to the Court how those two different
5 rates operate in making a present value calculation?

6 A Yes. The 3.75 for the first 20 years, three point --

7 Q All right.

8 A Sorry.

9 Q I think you said 3.75?

10 A I'm sorry. The 3.47 for the first 20 years, 3.67
11 thereafter, means that for the first 20 years of benefit
12 payments, they are discounted at 3.47 percent, and for
13 benefit payments thereafter they're discounted at 3.64
14 percent.

15 Q And the line item below that, can you explain how that
16 works?

17 A Similar mechanics. The 2.6 percent was used to discount
18 for the first 20 years, and the 3.43 percent was used
19 thereafter.

20 Q And you indicated that these rates were prepared by the
21 PBGC?

22 A Yes.

23 Q Is that right? And once again, for the record, can you
24 indicate the purpose by which -- or purpose for the PBGC
25 creating and publishing these rates?

1 A These rates are published for use in calculating the
2 value or the liability associated with terminating pension
3 plans.

4 Q Okay. And how often does the PBGC publish these rates?

5 A These rates are published quarterly.

6 Q And the 3.47 for the first 20 years and 3.64 percent
7 thereafter, that was the published PBGC rate for what period?

8 A The second quarter of 2014.

9 Q And the rates of 2.60 percent for the first 20 years and
10 3.43 percent thereafter, that was published for what period?

11 A July 1, 2013, that quarter.

12 Q That quarter? The quarter running July 1 through 9-30?

13 A 9-30, yes.

14 Q What is your understanding of how the PBGC goes about
15 developing these rates?

16 A The PBGC develops these rates by surveying life insurance
17 companies who sell annuities, who do annuity transactions, to
18 understand what the discount rates they use are for their
19 transaction. They compile the results and, as I understand
20 it, make adjustments to remove some of the profit margin
21 that's inherent in annuity purchase rates and publish these
22 rates for use in -- for use by terminating pension plans.

23 Q So, therefore, what is your understanding of the
24 relationship between the PBGC published rates and commercial
25 annuity rates?

1 A They're a proxy for commercial insurance rates.

2 Q As an actuarial matter, do you have an opinion whether it
3 is reasonable to calculate the present value of retiree
4 health liabilities in the context of a settlement using PBGC
5 rates?

6 A Yes, I do.

7 Q And what is your opinion?

8 A My opinion is based on Actuarial Standards of Practice
9 27, which I believe was discussed yesterday. That actuarial
10 standard is the standard which drives -- which determines the
11 discount rates that an actuary must use to perform
12 calculations. In looking to that standard, the current
13 standard -- in fact, the standard that I think Ms. Nichol
14 referenced yesterday that's coming into effect for this
15 quarter, specifically provides an example of a settlement
16 calculation and reports that an actuary may use annuity
17 purchase rates to perform a settlement calculation.

18 Q And, thus, what is your view of using PBGC rates for
19 settling a retiree health liability obligation?

20 A Well, as mentioned previously, this retiree health plan
21 is a defined benefit retiree health plan. It provides its
22 benefits in a series of future payments, albeit a little more
23 complicated than a pension plan because of medical inflation,
24 but, nonetheless, a series of periodic payments that are
25 similar to an annuity. The type of benefit is consistent --

1 or not inconsistent with a pension plan. This is -- an
2 annuity purchase rate for settling that type of periodic
3 payment is, in my opinion, reasonable with respect to a rate
4 to use.

5 Q And can you, again, just put into the record so it's
6 clear what the present value of benefit calculations that you
7 made when you used the 3.4 percent for the first 20 years,
8 3.64 percent thereafter, and the 2.60 percent for first 20
9 years and 3.43 percent thereafter?

10 A The 3.47 for the first 20 years, 3.64 thereafter,
11 resulted in a present value of 4.0 billion, and the 2.6 for
12 the first 20 years, 3.43 thereafter, resulted in a present
13 value of 4.49 billion.

14 Q And just to clarify again, this is for what population?

15 A This is for current retirees of the city.

16 MR. MILLER: Thank you. Thank you, your Honor. I
17 have no further questions.

18 THE COURT: Okay.

19 MR. SOTO: May I approach the witness, your Honor?

20 THE COURT: Yes.

21 THE WITNESS: Thank you. Okay.

22 CROSS-EXAMINATION

23 BY MR. SOTO:

24 Q We haven't met, Ms. Taranto. My name is Ed Soto. I have
25 a very few questions for you, and they relate to your

1 testimony --

2 THE COURT: Could you pull the microphone closer to
3 you? There you go.

4 BY MR. SOTO:

5 Q They relate to your testimony today and to your testimony
6 at your deposition. Let me start with making sure I
7 understand what you're not offering testimony on today. You
8 weren't -- am I correct, you weren't involved in Milliman's
9 work assessing pension liability, were you?

10 A I was not.

11 Q And you were not offering any opinions that relate to the
12 pension classes; correct?

13 A That's correct.

14 Q And your testimony today is solely about matters
15 pertaining to OPEB; correct?

16 A That's correct.

17 Q Okay. In Section 2 of your report that was an exhibit --
18 and I think they made one chart a separate exhibit, and we'll
19 go to that chart in a bit -- you list three opinions that
20 you're offering in this case; correct?

21 A I think so. I don't have it in front of me. Thank you.

22 Q And so --

23 A Thank you.

24 Q If you'll turn to Section 2 of that, you list three
25 opinions, I believe; correct?

1 A Yes.

2 Q And those are the only opinions that you're giving in
3 this case; correct?

4 A Yes.

5 Q And the third opinion relates to the range of possible
6 discount rates to calculate the OPEB claim in this
7 bankruptcy; correct?

8 A Yes.

9 Q And the purpose of applying a reasonable present value
10 rate is to approximate the current value of the stream of
11 future benefits; correct?

12 A Yes.

13 Q So it's a way of calculating the cost of the future
14 benefits in today's dollars; right?

15 A Correct.

16 Q Okay. The range -- that range of possible rates for
17 calculating the OPEB claims, that's what was set forth in
18 that table that we just saw; right?

19 A Those were the calculations that I performed, yes.

20 Q Okay.

21 MR. SOTO: Could you put up that table? I think
22 it's a new exhibit, 708, but -- there we go. There we go.

23 BY MR. SOTO:

24 Q That's the same one we were talking about a moment ago?

25 A Yes.

1 Q Okay. So starting from the top down, the first discount
2 rate is 4.5 percent; right? And then it goes down to four
3 percent, 3.5 percent, and then to the two lines that Mr.
4 Miller spent most time with; correct?

5 A Yes.

6 Q All right. And then it goes to the present values on the
7 right, and those benefits are measured in billions you
8 pointed out; right?

9 A Correct.

10 Q Okay. And as you sit here, you are not offering an
11 opinion as to which of those rates is the most appropriate
12 rate, are you?

13 A That's correct.

14 Q And it's your opinion that all of those rates are within
15 the range of reasonable discount rates to calculate the OPEB
16 claims; correct?

17 A They can be, yes.

18 Q Okay. But these discount rates that are on this chart
19 are not the entirety of the range of reasonable discount
20 rates that could be used to calculate the OPEB claim in this
21 case, are they?

22 A I haven't thought about that.

23 Q Okay. And it's possible, isn't it, for someone to use a
24 discount rate that is higher than the highest discount
25 rate -- well, let me go back. You know, I just thought of

1 something. Let me ask you to look in your deposition. This
2 might help refresh your recollection. On page 33, it's line
3 10 through 17, and I actually realize that that question was
4 asked to you by another attorney in this case. Question.
5 See if this refreshes your recollection.

6 "Is it your opinion that the discount rates that
7 are laid out in the table on the top of page 6 of
8 your report are the range -- are the entirety of the
9 range of reasonable discount rates that could be
10 used in calculating the OPEB claim?

11 Answer: Not necessarily."

12 So that's sort of consistent with your answer today,
13 but it takes it a step further; right? This is not the
14 entirety of the range. There could be others; correct?

15 A Correct.

16 Q And it's possible, isn't it, for someone to use a
17 discount rate that is higher than the highest discount rate
18 that you have on your table there on page 6, and as an expert
19 in this field you could still find that to be a reasonable
20 discount rate; correct?

21 A Potentially.

22 Q Now, the discount rates listed on page 6 of your report
23 are rates that you were specifically asked to value in
24 support of the city's negotiations with the Retiree Committee
25 on the OPEB claim; correct?

1 A Correct.

2 Q Okay. Would you agree with me that if the city had asked
3 you to calculate the city's liabilities to current retirees
4 with other potential discount rates that aren't on your chart
5 but that you believe could be within the range of reasonable
6 discount rates, as you previously testified, that you would
7 have calculated those, too?

8 A I certainly would have calculated rates to support the
9 city in their work, yes.

10 Q But you weren't asked to perform the calculations of OPEB
11 obligations for all of the possible ranges of reasonable
12 discount rates, were you, only the ones they gave you?

13 A Correct.

14 Q Okay. Now, you didn't perform a zero-percent discount
15 rate calculation, did you?

16 A That's correct.

17 Q And you've never been involved in a valuation where a
18 zero-percent discount rate was appropriate or would meet the
19 relevant accounting standards; correct?

20 A I have not personally been involved, but we did not
21 perform a GASB 45 valuation for the city.

22 Q And it's your view that to apply a zero-percent rate here
23 you would have to conclude that the city had no investable
24 assets; correct?

25 A Can you explain "here"? I'm sorry.

1 Q Here in this -- in these proceedings, in this situation.

2 A For this -- for settlement purposes? Is that your
3 question?

4 Q Yeah, as you were preparing here in this chart, yes.

5 A I'm not sure about that.

6 Q Let me ask you to look at page 76 of your deposition, see
7 if this will refresh your recollection, starting on line 9,
8 Evan.

9 "Question: What information would be required
10 about the city's finances that would allow you to
11 have an opinion regarding a zero-percent discount
12 rate that are not necessary for you to have an
13 opinion about a four-percent discount rate?

14 Answer," line 15, "A zero-percent discount rate
15 would be the result of an analysis that said that
16 the city had no investable assets and would be a
17 rate that might be determined under GASB 45
18 methodology."

19 Correct?

20 A That's what I said, yes.

21 Q And that was true then, and it's true now?

22 A The statement, yes.

23 Q Okay. So shifting gears a little bit, let's look at your
24 first opinion, which relates to the total present value of
25 future benefits. And I think you said those are -- I love

1 these acronyms -- the expected post-retirement benefit
2 obligation or EPBO; correct?

3 A Correct.

4 Q Okay. So the first thing I think you said you did was
5 calculate the EPBO associated with the pre-filing health plan
6 by replicating the June 30, 2011, valuation done by an
7 actuarial firm called Gabriel, Roeder, Smith; correct?

8 A Correct.

9 Q And you did that to make sure that you were correctly
10 interpreting the data and also to make sure that you were
11 correctly applying the plan's provisions; right?

12 A Yes.

13 Q Okay. And you determined that Gabriel, Roeder, Smith's
14 work had no material defects with respect to the valuation;
15 correct?

16 A We were able to replicate it, yes.

17 Q And you were comfortable that the range of difference
18 between your calculations when you replicated it and theirs
19 was not significant and you could still -- you were matching
20 what they had done; correct?

21 A Correct.

22 Q And after that analysis, then you took the next step of
23 doing an independent valuation of the EPBO as of July 1,
24 2012; correct?

25 A Correct.

1 Q And in performing that EPBO calculation, you included
2 both active employees and retirees; correct?

3 A Yes.

4 Q Okay. And you made certain assumptions about how many
5 then active employees would move from active to retirement
6 status or would pass away; correct?

7 A Correct.

8 Q And for those retirees who elected to opt out of
9 healthcare benefits, you assumed that for purposes of your
10 July 1, 2012, valuation that they would continue to opt out;
11 correct?

12 A Or a comparable number would continue to opt out, yes.

13 Q Okay. Fair enough. And you did the same thing when you
14 performed your calculation of the EPBO associated with the
15 2014 retirement health plan. You did not include retirees
16 who had either opted out or who had not opted into benefits;
17 correct?

18 A I'm not sure about that. I'd have to look at the work to
19 determine what assumptions we made about individuals,
20 particularly individuals who had access to a stipend.

21 Q I have to say you have had amazing memory here today, but
22 there are just a few things that your deposition might help.
23 Look at page 95 --

24 A Okay.

25 Q -- starting on line 23.

1 "Question: I apologize, and I actually wasn't
2 this person, but I do apologize. I've got to go
3 through this three steps now. When you performed
4 what I'm going to call your present value of
5 benefits for the 2014 retiree health plan
6 calculation, you did not include retirees who had
7 opted out or had not opted into medical coverage;
8 correct?

9 Answer: Can you give me a second?

10 Question: Sure.

11 Answer: That is correct."

12 You probably had more materials in front of you
13 then.

14 A Okay.

15 Q Does this refresh your recollection?

16 A That's what I said.

17 Q And it was true then, and it's true now, too?

18 A Presume, yes.

19 Q And when you were asked by the city to calculate the OPEB
20 claim in this case, you were told to include retirees who had
21 opted out or had not elected to opt into the pre-filing
22 retiree health plan; right?

23 A Say that again, please. I'm sorry.

24 Q So when you were asked by the city to calculate the OPEB
25 claim in this case, you were told by the city to include

1 retirees who had opted out or who had not elected to opt into
2 the pre-filing retiree health plan?

3 A Correct.

4 Q Okay. And there were, I think you said, 1,829 retirees
5 who were eligible for but had not elected healthcare benefits
6 that you included in your calculation here that you had not
7 included, for example, in your analysis of 2014 or 2012;
8 correct?

9 A Correct.

10 Q But as you sit here today, you don't know whether any of
11 those retirees who had chosen to opt out or who have chosen
12 not to opt in will, indeed, opt in, do you?

13 A I have not done any analysis.

14 Q Just one last area. You're familiar with the term
15 "actuarial value"?

16 A Yes.

17 Q Well, that makes one of us. And in reference to
18 measuring or evaluating healthcare programs, the actuarial
19 value refers to the share of the cost of the healthcare plan
20 that is paid by the health plan sponsor, which in my world is
21 usually the employee or some other source like Medicare as
22 opposed to the share of the cost of the healthcare plan
23 that's paid out of pocket by the participant; correct?

24 A Generally, yes.

25 THE COURT: Hold on.

1 THE WITNESS: I think you said employee.

2 THE COURT: Yeah. You said employee, and you meant
3 employer.

4 MR. SOTO: Oh, I'm sorry. Yeah. I told you there
5 was only one of us, Judge. That's true. Let's try this
6 again.

7 BY MR. SOTO:

8 Q So the actuarial value --

9 THE COURT: Okay. If you want me to keep up with
10 you because that's a really long question --

11 MR. SOTO: Slow down.

12 THE COURT: -- slow down, please.

13 MR. SOTO: Okay.

14 BY MR. SOTO:

15 Q The actuarial value refers to the share of the cost of
16 the healthcare plan that's paid by the healthcare sponsor,
17 which is usually the employer --

18 A Correct, yes.

19 Q -- or in some part may be paid by a governmental entity
20 like Medicare --

21 A Correct.

22 Q -- as opposed to the share that is paid out of pocket by
23 the participant, which is usually the employee?

24 A Correct.

25 Q Okay. So you measured the actuarial value of the 2013

1 retiree health plan; correct?

2 A Yes, I did.

3 Q And you found that the share of medical spending paid by
4 the plan or outside sources for Medicare-eligible retirees
5 was 90 percent, so you found that the actuarial value for the
6 Medicare-eligible retirees was about 90 percent; correct?

7 A Correct.

8 Q Okay. And you found that the share of the medical
9 spending paid by the plan or outside sources for non-
10 Medicare-eligible retirees was 83 to 90 percent, and so you
11 found that the actuarial value for non-Medicare-eligible
12 retirees ranged from 83 to 90 percent; correct?

13 A Correct, with one exception. For the non-Medicare-
14 eligible plans, it was entirely the plan that paid for it.
15 There was no Medicare equivalent.

16 Q Okay. Fair enough. And it's true that if a city paid 50
17 percent of the costs for a particular participant and
18 Medicare paid 40 percent of the costs and the participant
19 ended up paying only 10 percent out of pocket, that the
20 actuarial value for such a health plan would be 90 percent;
21 correct?

22 A If the participant paid ten percent, yes.

23 Q Okay. But nowhere in your report do you calculate the
24 actuarial value for the 2014 healthcare plan, did you?

25 A No, I did not.

1 Q Okay.

2 MR. SOTO: I think I have no more questions. Thank
3 you.

4 CROSS-EXAMINATION

5 BY MR. BRILLIANT:

6 Q Hi, Ms. Taranto. We've never met. I'm Allan Brilliant
7 representing MIDDD. I'm just going to have a few questions.
8 With respect to the chart that we looked at in your report
9 with the discount rates and the present value of benefits --
10 it's on page 6 of your report, which is Exhibit 456?

11 A Yes.

12 Q Now, I believe you testified that with the two
13 adjustments that you made at the city's request that this
14 really gives the outside, you know, brackets the outside
15 amount of the full amount of the present value of the
16 benefits; is that right?

17 A With respect to the two data assumptions, yes.

18 Q Right. And those data assumptions are -- if put into
19 this chart are 400 to 500 million?

20 A Roughly, yes.

21 Q So just assuming these discount rates, so if you
22 subtracted, you know, roughly 400 million for all of them
23 with respect to the highest number you would get, you know,
24 \$4.09 billion; is that right?

25 A If I subtracted 400 million, yes.

1 Q And I'm right, aren't I, that the -- under the plan the
2 amount that the city agreed to for the calculation of the
3 claim is 4.3 billion; is that right?

4 A I believe so. I don't recall off the top of my head.

5 Q Okay. So that number would be larger than the -- you
6 know, if you adjusted, you know, for the -- you know, for,
7 you know, the other amounts, the total amount that was
8 settled is larger than the highest number on your chart with
9 that adjustment; isn't that right?

10 A Mathematically, yes.

11 MR. BRILLIANT: I have nothing further.

12 THE COURT: Thank you. Any further questions for
13 the witness?

14 MR. MILLER: Very briefly, your Honor.

15 REDIRECT EXAMINATION

16 BY MR. MILLER:

17 Q There was a mention of GASB 45. What is GASB 45?

18 A GASB is the government accounting standard that applies
19 to retiree medical plans for governmental entities.

20 Q Does GASB 45 address pensions at all?

21 A No, not that I'm aware of.

22 MR. MILLER: No further questions.

23 THE COURT: Thank you. Any further questions for
24 the witness?

25 MR. SOTO: No, your Honor.

1 THE COURT: All right, ma'am. You are excused.

2 THE WITNESS: Thank you.

3 THE COURT: Thank you very much for coming today.

4 (Witness excused at 3:07 p.m.)

5 THE COURT: We'll be in recess now for afternoon
6 recess until 3:25, please.

7 THE CLERK: All rise. Court is in recess.

8 (Recess at 3:07 p.m., until 3:26 p.m.)

9 THE CLERK: All rise. Court is back in session.
10 You may be seated.

11 THE COURT: Sir.

12 MR. IRWIN: Good afternoon, your Honor. Geoff
13 Irwin, Jones Day, for the city. The city would next call
14 Michael Plummer as a witness. I have distributed some
15 binders for the Court and for staff. They're on the table
16 here and one in the witness well as well.

17 THE COURT: Please raise your right hand.

18 MICHAEL PLUMMER, CITY'S WITNESS, SWORN

19 THE COURT: All right. Please sit down.

20 DIRECT EXAMINATION

21 BY MR. IRWIN:

22 Q Welcome, Mr. Plummer.

23 A Thank you.

24 Q You and I have met before, but can you please state your
25 full name for the record?

1 A Michael John Plummer.

2 Q And where do you live?

3 A New York City.

4 Q And by whom are you employed?

5 A Artvest Partners.

6 Q In what business is Artvest partners?

7 A Artvest Partners provides art and financial advice to --
8 art finance advice to private clients, art businesses, art
9 professionals, and Fortune 500 companies.

10 Q And what type of advice does Artvest provide to those
11 clients?

12 A We advise clients on buying and selling activities,
13 broker art loans for them, the disposition of large
14 collections, negotiate with the auction houses for best
15 terms, guarantees, that sort of thing.

16 Q Were you retained by the city and by the Detroit
17 Institute of Arts in 2014 in connection with this bankruptcy
18 matter?

19 A I was.

20 Q At a very high level and without telling me what those
21 opinions are, what were the principal opinions that you were
22 asked to analyze?

23 A I was asked to evaluate the value of the DIA collection
24 in totality. I was asked to evaluate the recommendations for
25 monetization from Christie's. I was asked to evaluate the

1 offers of interest from another party, from one of the
2 creditors, and I was -- I believe that those were the three
3 things.

4 Q Were you asked to provide opinions on sale conditions
5 relating to --

6 A Yes. I was asked to provide sales -- yes, yes. I was
7 asked to provide sales conditions.

8 Q And are you prepared to describe for the Court the
9 process behind that analysis and your results?

10 A I am.

11 Q Before we do that, let's talk about your education and
12 your background. Where did you go to college?

13 A I went to the Wharton School of the University of
14 Pennsylvania.

15 Q And when did you graduate?

16 A 1980.

17 Q What degree did you receive?

18 A A bachelor of science in economics.

19 Q In economics. You had economics training at --

20 A Yes, I did.

21 Q And did you study any art or art history?

22 A I did study art history at Penn.

23 Q Okay. Did you take -- what form did that take?

24 A It was a survey course at Penn.

25 Q And what did you do after graduating from Penn in 1980?

1 A Well, that art history course inspired me a passion for
2 and love of art, so I set about actually visiting most of the
3 major museums of the world and major collections of the world
4 and got a job at Sotheby's in the fall of 1980 after I
5 graduated from Sotheby's --

6 Q How long --

7 A -- from Wharton.

8 Q From Wharton. How long did you work at Sotheby's
9 starting in -- in 1980; right?

10 A Yes.

11 Q Okay. How long did you work there?

12 A Till the beginning of 1996, so 16 years.

13 Q All right. And what was your first position at
14 Sotheby's?

15 A I was -- I worked in the treasury department, and I was
16 responsible for extending credit, collecting money from
17 dealers, negotiating deals with dealers, and managing one of
18 Sotheby's very first art loans, which was managing the
19 collateral, doing interest calculations, making sure property
20 was coming in and out to keep the loan to value ratio at a
21 certain level.

22 Q And what was your title at the time?

23 A It was account manager.

24 Q Okay. Was there any art valuation associated with
25 managing art loans at that time?

1 A I would work with the specialists at Sotheby's to ensure
2 that there were values on the works of art that were included
3 in the loan and that they were revalued periodically to make
4 sure that the value of the collateral was maintained at a
5 certain level.

6 Q How long were you an account manager at Sotheby's?

7 A About three and a half years.

8 Q And what position did you take next?

9 A Business manager at Sotheby's for the Asian art division.

10 Q And how did your job function -- roles and
11 responsibilities change in connection with that position?

12 A Well, in that position I was actually on the selling side
13 of the business. I was imbedded in various expert
14 departments, specialist departments, where I worked with the
15 specialists to accumulate their values for their upcoming
16 sales and assemble them into a forecast for the sales that
17 the company would then use to determine its own larger
18 financial forecast, its spending on catalogs and marketing
19 expenses, and establish a solid forecast for the company for
20 the next six months to a year.

21 Q Did you personally play a role in financial forecasting
22 for Sotheby's at that time?

23 A Yes, I did. I was responsible for forecasting for that
24 division of the company.

25 Q And how did you work with the specialists in connection

1 with your forecasting responsibilities?

2 A Well, we would sit down and look at the estimates that
3 they were putting in for a sale, and we would determine what
4 the realistic sales rate would be, whether or not they would
5 sell 80 percent of it or 90 percent of it or 6 percent of it,
6 what the market conditions were, whether or not they were
7 lowballing their estimates to get interest in -- from buyers
8 and what the real numbers should be, where the sale would
9 really likely end up.

10 Q Was part of your responsibility trying to determine if
11 low estimates as opposed to high estimates would be hit at
12 auction?

13 A Yes.

14 Q And how did you do that?

15 A Well, you would look at market conditions, past sales.
16 You would look at sort of general comments going on in the
17 trade, amongst the trade, economic trends, what the
18 specialist's track record was in the past for hitting their
19 mark as it were, and the strength of the sale overall, the
20 quality of the property, whether it was fresh or it was
21 property that had been around for awhile, whether it was more
22 dealer property or fresh private collector property, which
23 tended to do better.

24 Q And how long were you the business manager of the Asian
25 art division?

1 A For approximately three years.

2 Q What did you do after that?

3 A After that I moved to the real estate division where I
4 became effectively the COO of that division and where I was
5 responsible for forecasting, financial forecasts, financial
6 operations and marketing.

7 Q That was still at Sotheby's?

8 A That was still at Sotheby's.

9 Q So that's what? 1987 or so?

10 A That would have been about nineteen eighty -- yeah,
11 eighty -- end of '87, beginning of '88.

12 Q Okay. And how long were you with the real estate
13 division?

14 A Again, about three and a half, four years.

15 Q Okay. So taking us into the early '90s.

16 A Right.

17 Q What position did you occupy next at Sotheby's?

18 A I was recruited back to the auction company to manage
19 their marketing expenses in the face of the downturn of --
20 the market downturn of 1990, '91.

21 Q So you were in the marketing division at that point in
22 time?

23 A Yes.

24 Q Did there come a point in time when you assumed a
25 different role within the marketing department?

1 A Yeah. Within two years I was running the marketing
2 division and managing marketing expenses and working with
3 specialists to budget and plan marketing operations for sales
4 related to their estimates and their forecasts for their
5 specific auctions upcoming.

6 Q Did you run the marketing department for all of the
7 company or part of it?

8 A For all of North America and -- North and Latin America,
9 for all of the Americas and Asia.

10 Q Did you have any occasion in connection with that
11 position to work with the company's budgets or forecasting?

12 A Yes, I did.

13 Q And please describe that.

14 A Well, again, it was sort of a step up from being a
15 business manager. I was now working at a higher level with
16 the specialists and with the division heads, as it were, and
17 working with the bigger sales and making sure that they were
18 properly marketed and marketed within an affordable or cost-
19 effective budget that fit the scale of the sale.

20 Q Okay. And how long were you in that position?

21 A Two years.

22 Q All right. Does that take us through the end of your
23 employment at Sotheby's?

24 A Yes, it does.

25 Q And that was, I think you said, 1996?

1 A Correct.

2 Q Okay. Fast forwarding a little bit, did there come a
3 point in time when you took a position at a company by the
4 name of Fernwood Art Investments?

5 A Yes.

6 Q Okay. And what had you done -- when was that, by the
7 way?

8 A That was in 2003.

9 Q Okay. What had you done between 1996 and 2003?

10 A I had first worked at a marketing and branding firm
11 called Carbone Smolan, who I had actually hired to work for
12 me at Sotheby's when I was head of marketing to rebrand
13 Sotheby's, and we together rebranded Christie's. And then I
14 went on to start an on line technology business in the art
15 space that provided art data to appraisers and inventory
16 services to art collectors.

17 Q And what was the nature of the business at Fernwood Art
18 Investments?

19 A Fernwood was a new kind of business, the first of its
20 kind in America, which was set up to bring financial
21 practices to the art world. It was founded by an ex-Merrill
22 Lynch executive, and it was -- its ambition was and its
23 business plan was to bring -- make art into -- promote art as
24 an asset class and justify it as an asset class, create art
25 funds and bring financial discipline to the art world so that

1 we were not only creating art funds but we were doing
2 financial analysis. We were doing sector analysis of
3 volatility, comparative performances of different sectors
4 against each other and against equity markets and bond
5 markets, and how art would fit into an overall portfolio
6 looking at present values of collections, future values of
7 collections, all sorts of things like that.

8 Q And what was your position at Fernwood?

9 A I was president and chief operating officer.

10 Q And what was your role? What did your role include among
11 the various activities that you just described?

12 A My primary role was marrying the financial with the art
13 so that I was the most knowledgeable person in the company on
14 the art market, so I had to translate the financial practices
15 and tools into the reality of the art market. I was also
16 responsible for hiring the art specialist team of advisors
17 who we were lucky enough to get some of the leading art
18 dealers in the industry at the time, and I was responsible
19 for engaging with them and working with them to help set up
20 the indices we used, define the sectors in the funds that we
21 were creating and interface with them on a regular basis just
22 on market intelligence.

23 Q So you've mentioned art funds a couple times. Did you
24 have a personal role in connection with launching an art
25 fund?

1 A Yes. We created two art funds. One was called the
2 Sector Fund, and one was called the Opportunity Fund. And we
3 were -- we had put them through due diligence at Merrill
4 Lynch and had gotten approval to sell them to --

5 Q Well, let's just step back for a minute. I'd like to
6 know more about an art fund and how it works.

7 A Sure.

8 Q What was the idea at Fernwood behind the particular art
9 fund that you were about to launch?

10 A Well, the idea was that the fund was structured in a
11 way -- there were two funds. One was segregated into eight
12 sectors, which covered different sectors of the art market,
13 which, as I was suggesting earlier, performed differently and
14 created a sort of balanced fund approach to the art market.
15 And the other was an opportunity fund, which was set up to
16 take advantage of distressed situations or unique
17 opportunities that would arise in the art market.

18 Q And was this a buy and hold fund? Is that the idea?

19 A The Sector Fund was a buy and hold fund. The Opportunity
20 Fund was more of a trading fund, so it would have performed
21 more like a dealer.

22 Q Okay. What was the time horizon for the buy and hold
23 fund?

24 A The time horizon for the buy and hold fund was roughly --
25 again, it would depend on opportunities that presented

1 themselves, but it was anticipated to be about a two- to
2 three-year acquisition period, a three- to four- or five-year
3 holding period, and then a three- to four-year disposition
4 period.

5 Q And what's the rationale for that? Why do you have art
6 assets in that portfolio that you're holding over that time
7 period?

8 A Well, you're waiting for, to some extent, the market to
9 increase in value. To another extent you would -- we had
10 planned to manage the art so that it would enhance its value
11 so that we were planning to put it in museums and other
12 things that would raise its value, conduct research on
13 provenance and other things that would enhance its value, so
14 time would add value to it plus those additional attributes
15 or aspects that we were to engage in.

16 Q In connection with soliciting participation or investment
17 in this fund, what was the targeted rate of return?

18 A Fifteen to eighteen percent, and we were actually hoping
19 to get closer to eighteen percent.

20 Q And why is that? Why was the rate so high?

21 A Because investors, especially at that time, we were -- as
22 I said, we were the first to be doing this in the United
23 States -- were very skeptical of art as an asset class, and
24 they felt that it was -- with some justification, as our
25 research showed, that it was riskier and more volatile than

1 other sectors of the market and, therefore, that it merited a
2 higher return to account for or offset that volatility, so
3 they expected a return of 15 to 18 percent.

4 Q And how did you select the pieces of art or how were you
5 to select the pieces of art that would be placed into this
6 portfolio?

7 A Well, we were intending to work with the specialist that
8 we had hired to identify those works of art. We also were
9 intending to source the art mostly privately because it was
10 our general feeling and our strategy that buying art
11 privately is less competitive, and if you can source the
12 right deals, you're much better off than competing with
13 private collectors at auction where prices tend to run higher
14 these days.

15 Q Is there an economic incentive to buy a group of pieces
16 of art as a collection as opposed to individually at auction?

17 A Yes. If you can -- if you can find a collection intact
18 and buy it as such, you can sometimes get a significant
19 discount. There are some examples that were in my report of
20 that such as the Pierre Matisse Gallery.

21 Q Did you do -- we're going to -- we're going to get to
22 that in a moment, but did you do any economic or financial
23 forecasting or modeling at Fernwood?

24 A Yes, we did. We conducted a -- we conducted a report
25 which was breakthrough at the time, pioneering, and still to

1 this day is -- has not been replicated except for additional
2 work that my business partner and I have done at Artvest, but
3 we took the different art sectors of the art market, which,
4 you know, Ms. Fusco alluded to in her testimony yesterday,
5 that the art market is not one market but various sectors,
6 and those sectors are driven by the behavior and makeup of
7 the collector base that collects them, so, for example,
8 American art pre-1950 is almost -- is exclusively bought by
9 American collectors, generally older American collectors of a
10 certain age. Post-war and contemporary is bought by an
11 international crowd and a much younger crowd. Impressionist
12 and modern is yet a different crowd, and so all of these
13 sectors tend to perform differently based on the makeup of
14 those collecting bases, and they have over time different
15 performance attributes.

16 Q Okay. Did the fund that you're describing at Fernwood --
17 was it actually put to market?

18 A No, it wasn't.

19 Q Okay. And what is it that happened?

20 A Shortly after we got approval from Merrill Lynch to sell
21 it to their private banking group, I uncovered malfeasance on
22 the part of the CEO and that there was a large sum of
23 money -- investor money missing, and so shortly thereafter
24 myself and at my advice the expert specialist advisors
25 resigned collectively.

1 Q And was there a soft landing for you in terms of your
2 next career opportunity?

3 A Yes. Fortunately for me Christie's had been watching our
4 activity at Fernwood with some admiration and envy, so they
5 hired me to bring that learning to them and develop not only
6 a fund business for them but also an art lending business for
7 them.

8 Q And when was that?

9 A That would have been in 2007.

10 Q Okay. In connection with your new employment at
11 Christie's, what is it specifically that they had asked you
12 to do?

13 A They had asked me to work with Goldman Sachs in setting
14 up four art funds for them and also to develop and manage a
15 loan portfolio for them.

16 Q Did Christie's have an art loan business at that time?

17 A They did not. They had a couple of one-off transactions
18 that they did for clients, you know, special clients who came
19 to them, but they did not have a dedicated business of that
20 where Sotheby's did, and they wanted to compete with
21 Sotheby's.

22 Q Okay. Let's take the art loan business first. What is
23 it that you did personally for Christie's in connection with
24 getting that business up and running?

25 A Well, I oversaw what then was a multi-million dollar

1 portfolio of art loans and developed best practices and
2 underwriting procedures and implemented KYC, which was the
3 know your client practices that were developed by the
4 financial industry after 9-11. I also -- sorry.

5 Q That's okay. Let me ask you what -- was there a certain
6 amount of education that Christie's required in connection
7 with learning this new business?

8 A Yes. Yes, yes, yes, yes. They were new to the lending
9 business, so, again, I had to introduce them to best
10 practices, loan to value ratios, those sorts of things. Also
11 they had no banking relationships which facilitated art
12 lending. They had banking relationships for loans for the
13 operating business, but they didn't have banking
14 relationships to support the lending business, so I was
15 responsible for reaching out to banks and setting up those
16 relationships such as with Barclays, U.S. Trust and also
17 Royal Bank of Canada.

18 Q Did these entities -- and I mean both Christie's, your
19 employer, and the potential lenders -- did they have
20 experience with valuing art as collateral for an art loan?

21 A Christie's had a little bit of experience but not enough,
22 and I had to upgrade that experience or that knowledge base.
23 Barclays had none, so that was actually an extended process
24 of educating them because they had some misperceptions about
25 how one liquidates a large portfolio in the art market and

1 various factors that can apply that can cause a portfolio to
2 lose value. And RBC was new to the business as well, but
3 U.S. Trust already had an established business.

4 Q Is there a generally accepted loan to value ratio that is
5 used in the art lending business?

6 A Yes.

7 Q And what is it?

8 A Almost universally and consistently it's 50 percent loan
9 to a -- to the value of the collection, and value we're
10 talking low estimate of the collection, low auction estimate.

11 Q So if you have a -- if you have a range of estimates and
12 a low auction estimate and a high auction estimate or a fair
13 market valuation, which points is the loan to value ratio
14 tied to?

15 A I'm sorry. Ask the question again.

16 Q Yes. Which of those values do you mark your loan to
17 value, your 50-percent rule, the low estimate or the high
18 estimate?

19 A The low estimate.

20 Q And why is that?

21 A Because you're assuming a -- I wouldn't say a worst case
22 scenario. You're assuming that the property is going to be
23 sold quickly if you were in a distress situation, so you want
24 to make a conservative and realistic estimate of what you're
25 going to net in a six-month period or a very short period of

1 time to liquidate what you have to to recover your capital.

2 Q And was that standard practice back at this point in
3 time?

4 A It was standard practice at that point in time. It was
5 standard practice at Sotheby's. It is today. It's standard
6 practice at every art lender out there.

7 Q Okay. Tell me about your -- tell me about whether
8 these -- let's talk about the art fund business at Christie's
9 as well. What did you do in capacity with getting an art
10 fund off the ground?

11 A We worked extensively with Goldman Sachs, although we at
12 Christie's did all the heavy lifting. We did the -- had the
13 intellectual capital from what I brought over from Fernwood.
14 We structured four funds, and one was an impressionist and
15 modern fund for that sector. One was a post-war and
16 contemporary sector. One was an old master fund, and the
17 other was what we called a BRIC fund to take the -- get the
18 advantages of emerging markets. And these funds were -- the
19 concept behind having four funds was that Goldman Sachs
20 wanted to take four different products to its high net worth
21 clients in Europe most specifically and give them options in
22 terms of risk levels so that, for instance, the BRIC fund
23 would be the highest risk, higher return -- highest return
24 fund, and the old master fund would be the most conservative,
25 lowest return fund. It was not unlike how one creates funds

1 in equity markets.

2 Q Did those funds get off the ground? Were they launched
3 from Christie's?

4 A No, they did not. Unfortunately, around that time came
5 the crash of 2008, and so we reconfigured the funds from four
6 funds to make it into -- this was in the fall of 2008 -- into
7 one fund that was opportunistic, which would be a distress
8 fund. In early 2009 we went to market with it -- excuse
9 me -- in Europe, and we soft-circled about a hundred million
10 dollars for the fund, and we came back to Christie's, but,
11 unfortunately, Christie's was in the -- at the nadir of its
12 problems from the market crash. They had -- there were
13 various setbacks in their core business, and they were unable
14 to come up with the \$5 million good faith investment that
15 they had to make in the fund, so the whole project was
16 scrapped.

17 Q And what became of Christie's financial services? I
18 think we're in the 2009 --

19 A Yeah.

20 Q -- time period or so.

21 A It was shut down as part of the general pullback at
22 Christie's, and they stopped doing art loans but actually in
23 the last nine months are reentering that business.

24 Q And so what did you do next in 2009?

25 A In 2009 the fellow I worked with at Christie's who I met

1 there, who was working with me on the art funds, who had a
2 background in finance, he and I started Artvest Partners.
3 And we brought with us all of the intellectual capital from
4 Christie's, which was my right as per my contract with
5 Christie's, and we set up Artvest to advise on art
6 investments and art loans and all the things we talked about
7 earlier.

8 Q And so do clients come to Artvest for financial
9 counseling in connection with dealing with art as an
10 investment?

11 A Yes. They come to us for advice on selling, on buying,
12 on restructuring collections for investment purposes, and for
13 liquidating collections and maximizing the value.

14 Q How about art loans?

15 A And -- yes. We get requests for art loans almost on a
16 weekly basis.

17 Q All right. Do you have reason to interact with
18 specialists and dealers in connection with your work at
19 Artvest?

20 A Yeah. We often partner with dealers in buying and
21 selling art, in valuing art, and also we own an art fair
22 called Spring Masters New York.

23 Q What is an art fair?

24 A It is an event that is held once -- in this case, once a
25 year at the Park Avenue Armory in May where there are

1 approximately about 50 or so dealers who rent booths from us
2 and sell art, and so we have a very intimate relationship
3 with these dealers and are in a dialogue with them weekly
4 about the nature of their businesses and the nature of the
5 market.

6 Q What is the Art Investment Council?

7 A The Art Investment Council is a not for profit group that
8 Jeff and I set up about three years ago to promote best
9 practices in the art investment industry because at the time
10 there were a lot of new people entering it who either didn't
11 have the credentials or the know-how and were putting things
12 out there that we felt were putting at risk the whole idea of
13 art investment.

14 Q Have you been published? Do you have publications in
15 your name, sir?

16 A Yes. At Artvest we published three different market
17 analyses in the period of around 2011, 2012, that were very
18 well regarded at the time. They were distributed to
19 collectors and art professionals and investment
20 professionals. And we published them for awhile but then
21 stopped publishing them because the purpose of them was to
22 build our brand and awareness, and after a certain point that
23 was done, and we now get calls from the Wall Street Journal
24 and the New York Times and Bloomberg and various outlets for
25 opinions on the art market, so we didn't need to self-publish

1 anymore.

2 Q Okay. By the way, back to -- on the Art Investment
3 Council, are there any similar organizations to the Art
4 Investment Council that you're aware of?

5 A That are active currently, no.

6 Q Do you have occasion to lecture or speak regularly?

7 A Yes, I do.

8 Q And can you describe some of those?

9 A I frequently lecture at the Sotheby's -- the Institute of
10 Art at Sotheby's, at Christie's education, at the NYU
11 program, and have spoken at Wharton to the Wharton graduate
12 students --

13 Q On what --

14 A -- on the art market.

15 Q Yeah. On what topics I was going to ask?

16 A On the sector analysis, on the volatility of the art
17 market, on the illiquidity of the art market, on the
18 different sectors, on how the art market performs relative to
19 equity markets, that sort of thing.

20 MR. IRWIN: Your Honor, at this point, I would move
21 to qualify Mr. Plummer as an expert in the commercial art
22 markets, including valuation and market dynamics.

23 MR. SOTO: No objection.

24 THE COURT: You may proceed, sir.

25 MR. IRWIN: Thank you.

1 BY MR. IRWIN:

2 Q Mr. Plummer, before we get into some of your opinions,
3 I'd like to ask you some questions about some general art
4 market dynamics --

5 A Sure.

6 Q -- if we could. In your analysis, did you consider sales
7 volumes and values at the low end and the high end of the
8 marketplace?

9 A Yes.

10 Q Did you prepare any visuals in connection with that
11 analysis?

12 A Yes, I did.

13 Q Okay. I'd like you, if you could -- there's a binder.
14 There should be a binder in your witness well, but we'll put
15 it up on the screen, City 644. You see that, sir?

16 A Yes, I do.

17 Q What is City Exhibit 644?

18 A 644 shows the extreme nature of the art market in that --

19 Q Well, before we get into the content, tell me what it
20 purports to depict.

21 A It reports to predict the bands of value, lots sold by
22 value versus lots sold by volume, and so the bright red chart
23 is lots sold by volume, and the dark red bands are lots sold
24 by value. And so as you can see from this, there is a very
25 high preponderance of activity in the lower ranges of the art

1 market and a very small amount of activity in the upper range
2 of the art market, so --

3 Q Let me ask you first did you prepare this chart?

4 A Yes, I did.

5 Q And where did you get the data for it?

6 A The data came from Art Economics and TEFAF, TEFAF, the
7 European Fine Art Foundation, who prepare this report on an
8 annual basis based on the survey of the art market, and it's
9 one of the more reliable sources out there on the art market.

10 Q And this purports to cover art sales in 2013; is that
11 right?

12 A Yes, it does.

13 Q Is that all art sales?

14 A Yes, it is.

15 MR. IRWIN: Your Honor, before I go further, I'd
16 like to offer City Exhibit 644 as a demonstrative.

17 MR. SOTO: No objection, your Honor, as a
18 demonstrative.

19 THE COURT: It is admitted.

20 (City Exhibit 644 received at 3:57 p.m.)

21 BY MR. IRWIN:

22 Q Mr. Plummer, why is this chart important in your
23 analysis?

24 A Well, for us it makes the point that the art market is
25 very distorted towards the low end in terms of transaction

1 volume, and as you can see from this, about 50 percent of
2 transactions fall below 4.1 thousand, and about 90-some
3 percent fall below 69,000. And if you go to the upper end,
4 the values that are reported --

5 Q I just mean to interrupt -- you said 42.1 percent fall
6 below 4.1 thousand; is that right?

7 A Forty -- well, in total, it's about --

8 Q Right. It would be the -- it would be the sum of the
9 first three red columns --

10 A Yeah.

11 Q -- is that right?

12 A Correct.

13 Q Okay.

14 A Correct. So that below 70,000 you're looking at 90-some
15 percent of the market. And when you get up to the higher end
16 of the market, say sales over 13.8 million, which is -- which
17 are the sales that you see reported in the press, you're only
18 dealing with two-hundredths of a percent of the transaction
19 volume of the market, so we feel that this is an important
20 chart to explain and have used it often to explain how the
21 art market actually breaks out and that the reports one hears
22 in the press about record prices are misleading as to the
23 overall volume and activity -- nature and volume of activity
24 in the art market. This is also a fair reflection of what is
25 out there in collections and in museums that there's just a

1 high concentration of value in very small numbers, and a
2 large proportion of the property out and around in the art
3 market is of little value.

4 Q Are you familiar with the term "market sectors"?

5 A Yes.

6 Q And what does that term mean to you?

7 A It means different segments of the art market that have
8 different characteristics based on the period of art and the
9 style of art that's being sold and the type of collector base
10 that is buying it.

11 Q In connection with your work on this matter, have you had
12 occasion to consider how the art market has performed by
13 sector?

14 A Yes, I have.

15 Q Okay.

16 MR. IRWIN: Can I please put up City Exhibit 645,
17 which should also be in your binder, but will also be on your
18 screen?

19 BY MR. IRWIN:

20 Q Do you have that in front of you?

21 A I do.

22 Q What is contained in City Exhibit 645?

23 A This exhibit shows the market share by sector of the fine
24 art auction market.

25 Q Did you prepare this chart?

1 A I prepared it with data from art economics and TEFAF.

2 Q And over what time period does this chart purport to
3 cover?

4 A This is 2013 activity.

5 Q Okay. And all sales or something less than all sales?

6 A This would be auction sales.

7 Q Auction sales in 2013?

8 A Not counting private sales, auction sales. And this
9 shows you that the left chart is sales by value. The right
10 chart is by volume. They're actually not that different, but
11 the left chart shows you that certain sectors dominate the
12 art market, and this is the fine art part of the art market.
13 This does not include decorative art. But of the fine art
14 market, post-war and contemporary has a 46-percent market
15 share, so it is by far the leader and the fastest growing.
16 Modern art is the second largest sector at 29 percent.
17 Impressionist and post-impressionist art is 13 percent, and
18 old master paintings is 10 percent. And American art would
19 fit into that other sector of two percent because it's not
20 globally traded.

21 Q So what proportion of the overall art marketplace in
22 terms of commercial sales is occupied by these four sectors?

23 A It's in the -- it's, yeah, 98 percent.

24 Q Ninety-eight percent by value?

25 A Right.

1 Q Is that right?

2 A Right.

3 MR. IRWIN: Your Honor, we would offer at this point
4 in time City Exhibit 645 as a demonstrative.

5 MR. SOTO: No objection as a demonstrative.

6 THE COURT: All right. It is admitted.

7 (City Exhibit 645 received at 4:02 p.m.)

8 BY MR. IRWIN:

9 Q All right. Could we please take a look at City Exhibit
10 646? Mr. Plummer, in connection with this exercise, did you
11 have occasion to consider how the various art sectors have
12 performed over time?

13 A Yes, I did.

14 Q And is Exhibit 646 one of your charts?

15 A Yes, it is.

16 Q Okay. What are you purporting to depict in 646?

17 A We're purporting to depict the -- from the period of 2003
18 to 2013 the growth of value and sales volume by year, and the
19 bars represent value, and the line represents volume. And
20 you can see from 2003 --

21 Q Well, let me ask you to pause just for a moment just so
22 we understand what the chart is. Is this chart one of the
23 sectors, or is this a total art market chart?

24 A This is just the modern art sector.

25 Q The modern art sector, which is one of the four sectors

1 we just --

2 A Correct

3 Q -- looked at?

4 A Correct.

5 Q Okay. And it purports to track the modern art sector
6 performance from 2003 to 2013; is that right?

7 A Correct.

8 Q Okay. Can you describe what conclusions you draw from
9 this data focusing for the moment on how the market performed
10 from 2003 to 2011?

11 A Well, from 2003 to 2011, there was exponential growth
12 with the exception of 2008 and 2009, which was a result of
13 the great recession or the global economic crisis, but the
14 art market recovered very quickly in 2010, and in this
15 particular sector it peaked in 2011.

16 Q To what do you attribute all of the growth that we see in
17 a chart like this all the way through 2011?

18 A Well, we see this pattern in almost every sector, and we
19 believe that it is a function of the growth in
20 billionaires -- in the sudden growth of billionaires that is
21 an after effect of the joining of the global economy of
22 Russia, China, India, and eastern Europe in the '90s. And
23 there was a bit of lag effect, so while those people were
24 making their billions in the '90s, the art market was
25 actually struggling, but only then in the early 2000s did

1 they turn to spending their money in the art market, and it
2 boomed tremendously and grew by such a large proportion.

3 Q Did you have occasion in connection with your analysis to
4 consider the same metrics for the other three principal
5 sectors that we looked at previously?

6 A Yes, we did.

7 Q And have they performed similarly over this time period?

8 A The impressionist and post-impressionist market performs
9 the same. The American market has performed similarly,
10 although a little less well, and the exception -- the
11 outliers, post-war and contemporary -- and actually old
12 masters has performed similar to this -- the outliers, post-
13 war and contemporary, because that market has come to stand
14 alone in terms of its performance.

15 Q Okay. Let's set that aside for a moment. Let's set
16 post-war and contemporary aside for just a moment. With
17 respect to the other three sectors, have they performed like
18 this?

19 A Yes.

20 Q Have you formed an opinion as to whether those other
21 sectors, including this one, for the time period from 2003 to
22 2011 would replicate the same growth for the next ten years?

23 A We have come to the conclusion that's extremely unlikely.

24 Q And why is that?

25 A Because global economic growth has slowed, and growth in

1 the art market tends to follow a period of high economic
2 growth. So with global growth slow now in the general
3 economy worldwide that there won't be growth in the --
4 significant growth in the art market for the next five years
5 or so or longer.

6 Q And what, in fact, has happened in your chart in City
7 Exhibit 646 after 2011?

8 A Well, indeed, in 2011 and two thousand -- or sorry --
9 2012 and 2013, except in the post-war market, all of the
10 other markets seem to have stalled.

11 Q Okay. So let's talk about post-war and contemporary
12 then. Did you perform a similar analysis for post-war and
13 contemporary?

14 A I did.

15 Q Okay.

16 MR. IRWIN: By the way, before I do that, your
17 Honor, could I offer City Exhibit 646 as a demonstrative?

18 THE COURT: Any objections?

19 MR. SOTO: Not as a demonstrative, your Honor.

20 THE COURT: It is admitted.

21 (City Exhibit 646 received at 4:07 p.m.)

22 MR. IRWIN: All right. Could we please publish City
23 Exhibit 653?

24 BY MR. IRWIN:

25 Q Do you have that in front of you, sir?

1 A 650 --

2 Q 653.

3 A 653, yes, I do have it.

4 Q What is depicted in City Exhibit 653?

5 A This is the post-war and contemporary sector, 2003 to
6 2013, again, by value and by volume.

7 Q And how has post-war and contemporary as a sector
8 performed differently than the other three principal sectors
9 we've discussed?

10 A Well, it differs in two significant ways. The first is
11 that, as you can see, from 2008 to 2009, the crash, the drop
12 in value is more significant, which points to our argument
13 about its volatility. The other is that after it recovered,
14 it has continued to grow and is continuing to grow. It is
15 actually booming. It is unlike all of the others. It is --
16 each year seems to exceed the previous year.

17 Q Is post-war and contemporary as a sector the only sector
18 that is performing in this manner?

19 A Yes.

20 Q Okay. Have you formed an opinion as to whether or not
21 this growth in post-war and contemporary is sustainable over
22 time?

23 A To the extent that it has been growing, it's not
24 sustainable, so there is a general perception out there that
25 I hold and others hold that there is a correction likely at

1 some point, though we can't say when that will happen, but
2 the growth has been so significant and unfettered that there
3 are concerns that it will not be sustained.

4 Q Can you address, if you could, whether or not this
5 particular sector has demonstrated volatility relative to
6 other art sectors?

7 A Yes. When we did the analysis of sector volatility, as I
8 was talking about, at Fernwood and then followed up with at
9 Christie's and whatnot, by far contemporary art is the most
10 volatile. It has the highest returns, but it is the most
11 volatile, so it had a correction in 1990 and '91, and it had
12 a significant correction in 2008 to 2009. And it tends to
13 suffer a correction in the range of 50 percent.

14 Q Okay. I think in the last chart we looked at the -- that
15 sector, too, suffered a decline from 2007 to 2009. Do you
16 recall that?

17 A Yes, I do.

18 Q Was the decline in the post-war and contemporary sector
19 more pronounced from 2007 to 2009?

20 A Yes.

21 Q How so?

22 A Well, it -- as I said, it was -- the indices that we had
23 at the time indicated a 50-percent decline in the index in
24 that period whereas impressionist and modern art and old
25 masters were showing declines in the range of 25 or 30

1 percent, so not nearly as bad as this. And as a general
2 rule, the further back in time a sector goes in history, the
3 less volatile it gets, so while post-war and contemporary is
4 the most volatile, impressionist and modern is less volatile,
5 and old masters is less volatile than that, so it tends to
6 follow chronology.

7 Q All right. With that background in mind, sir, let's turn
8 our attention to your valuation of the Detroit Institute of
9 Arts collection in this case.

10 A Okay.

11 Q All right. When did you begin your evaluation of the DIA
12 collection?

13 A In late May of 2014.

14 Q What did you know about the DIA at the time you accepted
15 this engagement?

16 A I knew it was a world-class institution considered by
17 many to be one of the top five or so museums in the country;
18 that it was an encyclopedic collection; that it had some
19 astonishing works of art, of course, the Bruegel, but also
20 the Gates of Ishtar, a gate from the Gates of Ishtar, a tile
21 from the Gates of Ishtar, of course, the Diego Rivera room, a
22 phenomenal American paintings collection, one of the best old
23 master paintings collection in America, a great German
24 exhibitionist collection, so it was -- I knew it to be a fine
25 institution.

1 Q Are you aware or were you aware at the time of any prior
2 example of a museum collection of this quality and
3 significance being sold to the marketplace?

4 A No. I had never heard of anything even remotely close to
5 this ever happening.

6 Q Did you become aware at the time or were you aware that
7 Christie's had performed an appraisal of some portion of the
8 DIA collection?

9 A I was aware of that, yes.

10 Q Okay. Did you incorporate that work in connection with
11 your own analysis?

12 A We did. We looked at it closely, and also having worked
13 at Christie's and known many of the -- and knowing many of
14 the people who worked on that appraisal and knowing their
15 practices and having reviewed it, we felt that it was a sound
16 ingredient in our evaluation of the collection.

17 Q And what did you understand Christie's to have done in
18 connection with their work?

19 A Well, that they had used a market data approach. They
20 had, whenever they could, examined the works in person and
21 that they created a fair market value appraisal. And, you
22 know, one of the things that appealed to me about Christie's
23 values -- and it was the approach that we were to take -- was
24 that Christie's has their -- unlike sort of a random
25 appraiser who may not be close to market activity, Christie's

1 has their finger on the pulse of the market, so when it comes
2 to valuing something like the Bruegel, the example that Ms.
3 Fusco gave in terms of the calculations of comparing the
4 Reubens and "The Card Players" was exactly the kind of logic
5 that's required for a sophisticated valuation like this.

6 Q Okay. So were you provided the Christie's data then?

7 A Yes, we were.

8 Q Okay. And what did you do with it?

9 A The way Christie's had done it in terms of phase one,
10 phase two, phase three was a little confusing for our
11 purposes, so we recast the data and recast it into bands of
12 value.

13 Q What were those bands?

14 A We cast it into what we call high-value property starting
15 with a low estimate of 750,000 under the assumption that in
16 the art world generally a million dollars is considered to be
17 the threshold for an important work of art, and by using a
18 750 low estimate, that basically was capturing that million
19 dollar mid-estimate. And then we segregated the rest of the
20 property from 750 below into sectors and into value bands
21 within sectors, so there were probably roughly about five or
22 six value bands from zero to a thousand, a thousand to 5,000,
23 five to 50,000, and on up to 750,000.

24 MR. IRWIN: Your Honor, I am reminded that I did not
25 offer City Exhibit 653 for demonstrative purposes.

1 MR. SOTO: No objection as a demonstrative, your
2 Honor.

3 THE COURT: All right. It is admitted.

4 (City Exhibit 653 received at 4:15 p.m.)

5 MR. IRWIN: Sorry for that interruption.

6 BY MR. IRWIN:

7 Q You were describing how you broke down the Christie's
8 data into value bands.

9 A Correct.

10 Q All right.

11 MR. IRWIN: Can we publish, please, City Exhibit
12 665? There we go.

13 BY MR. IRWIN:

14 Q Do you have that in front of you, sir?

15 A Yes, I do.

16 Q Sir, is this a table that you prepared?

17 A Yes, it is.

18 Q And what does it purport to show?

19 A It shows that of -- when we divided the Christie's into
20 these different groups, the Christie's COD property, we
21 determined that there were 68 objects that were greater than
22 750,000 with a low estimate of 427 million and a high
23 estimate of 812 million and that there were 1,654 works below
24 750,000 that totaled 27 million in the low estimate and 54
25 million in a high estimate. Then there was a group of

1 property that we felt was statistically significant for the
2 analysis that had been treated a bit somewhat dismissively in
3 the letter that Christie's sent, but we felt that it was
4 representative of a museum's collection, and, indeed, Ms.
5 Fusco more or less validated that in her testimony about the
6 low value property in a collection, and that was that they
7 had 1,038 items which they assigned a value to of effectively
8 zero, meaning somewhere between a thousand and zero.

9 Q Did that surprise you?

10 A No, not at all because, like the example we showed of the
11 transaction volume in the art market, there is a high
12 propensity for value at the low end, and their museums often
13 have items in their collection that have no commercial value
14 but are there for scholarly reasons or sentimental reasons or
15 historical reasons but really are not desirable on the
16 auction market.

17 Q Okay. Now, I notice in the first row you've got high
18 value works greater than 750, then lower than 750. Do you
19 see that divider?

20 A Yes.

21 Q What was the significance of \$750,000 as a --

22 A As a threshold?

23 Q Correct.

24 A Yes. Well, as I was saying earlier, the million dollars
25 is considered to be the break point for what is an important

1 work in the art market and what is not. It's a generally
2 accepted principle. Sotheby's and Christie's report their
3 sales over a million dollars as a matter of pride, and so to
4 capture that, because Christie's had used an estimate range,
5 we made the cutoff 750,000 because that would mean that that
6 was a mid-range of the hundred -- of \$1 million, so that
7 basically enabled us to capture everything that we felt was
8 around a million dollars in value.

9 Q Okay. And did you understand the Christie's valuation to
10 purport to include anything about sale conditions?

11 A No. We understood that each of these values was assigned
12 in isolation and a value just taken at a point in time and
13 not taking into account any impact of a sale or sale
14 conditions or volume discounts or any sale conditions or
15 economic conditions that might apply.

16 Q By the way, did you do anything to corroborate or cross-
17 check any of the Christie's valuations?

18 A Yes. We reviewed them and looked at them and found them
19 to be acceptable.

20 Q Okay. What did you do next structurally in terms of your
21 analysis?

22 A Well, we then solicited from the museum a list of
23 property that they felt was in excess of a million dollars
24 and got a list from them of approximately 420-some items, of
25 which 68 Christie's had already appraised, which left us with

1 a net grouping of about 350, which we decided we would
2 evaluate in the same manner that Christie's did using the
3 market data approach and setting a fair market value and a
4 range of values.

5 Q Okay. So why did you ask for a list of any type
6 reflecting works of art valued at a million dollars or more?

7 A We felt it was the most logical way to attack the
8 collection to look at where the value would be concentrated
9 because as in most collections and as was borne out with the
10 Christie's appraisal, the highest concentration of value in
11 the collection would be in the high value items.

12 Q And so were you trying to -- was Artvest going to
13 appraise in the manner that Christie's did high value items
14 that were not COD purchases?

15 A Correct. So we were comparing apples to apples.

16 Q And how did you go about doing that?

17 A I hired a team of four specialists, consulting
18 specialists, one with expertise in American paintings -- in
19 the sectors where the most -- the largest holdings were, one
20 in American paintings, one in European paintings, and another
21 in old master paintings, and then a separate specialist for
22 objects.

23 Q And did you visit the museum in order to carry out that
24 assignment?

25 A Yes, we did.

1 Q Okay. And did you go with the specialists?

2 A Yes.

3 Q Okay. And how did you go about valuing these pieces with
4 your specialists?

5 A Well, we examined them physically, though, just as
6 Christie's did, we did not take them off the wall. We did
7 not disrupt the museum. We were very conscious not to do
8 that. We went during normal business hours or normal museum
9 hours. We did not trouble the staff. So we looked at what
10 was on view. We did not remove anything from the wall or out
11 of a case. And we then looked for comparables. We had a
12 master database which we all had access to on Google
13 documents, and we sourced comparables through Artnet and
14 Artinfo and Askart, and then we looked at those comparables
15 and had various conversations about what those prices should
16 be and various factors and specifically instances where there
17 were one of a kind items that there were no comparables for,
18 which is often the case when you get into museum collections,
19 and then set a value for those 350 items.

20 Q How does your methodology compare with, say, the
21 methodology that Christie's employed?

22 A It's our sense that it was essentially identical.

23 Q Okay.

24 MR. IRWIN: Your Honor, I'm going to put a new
25 demonstrative up, but before I do, I'd like to offer for

1 demonstrative purposes City Exhibit 665.

2 MR. SOTO: For demonstrative purposes, no objection.

3 THE COURT: Thank you. It is admitted.

4 (City Exhibit 665 received at 4:22 p.m.)

5 MR. IRWIN: So can we put up, please, City Exhibit
6 666?

7 BY MR. IRWIN:

8 Q You have that in front of you?

9 A Yes, I do.

10 Q What is contained in City Exhibit 666?

11 A This is the objects other than what Christie's did added
12 to what Christie's did to come to a total valuation, and I
13 can go through it line by line.

14 Q Well, let's do it together. Let's start toward the
15 bottom. You've got an entry. It says "Total COD property,
16 2,773." Do you see that?

17 A Yes.

18 Q Okay. What line -- what values do you -- are you
19 assembling in that line?

20 A That is the -- that is the total valuation for Christie's
21 appraisal that they submitted to the city and with their low
22 estimate for the 2,773 items of 454 million and a high
23 estimate of 866 million.

24 Q Okay. Now let's move up to toward the top, and it says,
25 "Artvest evaluation of works greater than \$750,000." Do you

1 see that?

2 A Yes.

3 Q That line has -- for object numbers it has 350. Do you
4 see that?

5 A Correct.

6 Q Is that the process that you've been describing?

7 A Yes; correct.

8 Q Okay. And are those the values in the aggregate that you
9 assigned in connection with that exercise?

10 A They are. They are.

11 Q The next line says "Additional 73." What is that line in
12 reference to?

13 A When we visited the museum, we didn't want just to rely
14 on the data that the museum had given us. We wanted to do a
15 cross-check of what was there to make sure that we weren't
16 leaving important objects out, so we took photographs of
17 those things that we suspected were of higher value that were
18 not included in the list that the DIA gave us, and that came
19 to 73 items. And so we then -- but as that came so late in
20 the process, in terms of filing this report, we had not yet
21 finished doing an evaluation of all of these, so by the time
22 we filed this report, we put in an estimated number for those
23 extra 73, which was this number of 80 million to 164.

24 Q Okay. So this chart actually came from your report; is
25 that right?

1 A Correct.

2 Q Okay. At the time you provided your report, you had
3 identified these 73, but you hadn't finished the
4 valuations --

5 A Correct.

6 Q -- is that right?

7 A Correct.

8 Q When you finished the valuations, how did those compare
9 with the 80 million and 164 million low and high estimates?

10 A It was slightly lower than the low and a good bit lower
11 than the high. It came in to about 70 million for the low
12 and about 120 million for the high.

13 Q So are the actuals lower or higher than what is provided
14 here in this line?

15 A The actuals are lower than what's provided there.

16 Q All right. So that brings us to -- I see that you
17 subtotaled that on the next line, but there's a line that
18 says "remaining DIA." Do you see that?

19 A Correct, yes.

20 Q It's got a little more than 57,000 items in it.

21 A Right.

22 Q How did you approach the remaining items at the DIA that
23 were not individually appraised?

24 A Well, this we gave considerable thought to as to what
25 would be the most supportable and logical way to go about

1 this since with that many items you couldn't conduct a hands-
2 on appraisal or a valuation, so we knew that we had to do
3 this statistically or mathematically, so we needed to find
4 something that we could connect to the collection that was
5 logical. At an early stage, we looked at using data from
6 Sotheby's, Christie's sales, but we rejected that because we
7 felt that there was no logical connection as to what they
8 were selling on an annual basis as to what was in the
9 collection. Where we actually settled on was using the
10 Christie's data because the Christie's data was actually a
11 statistically significant sample being, you know, 3,000
12 objects, including the ones that had no value, and they were
13 broken out by sector. So we got a -- we got Christie's to
14 supply us with a native file of their appraisal, which I
15 mentioned earlier, and we divided it into sectors and into
16 what we'd refer to as price bands or lot bands in the art
17 world, and -- that I mentioned earlier from zero to one to
18 one to five to five to 1,000, and then we also got a data
19 download from the DIA of their sectors, and we eliminated all
20 of the items in the DIA collection that were in excess of
21 750,000, which had already been accounted for in the hands-on
22 inspection. And then we extrapolated the weighted averages
23 from the Christie's data by sector and applied that to the
24 DIA data by sector, and this -- these are the numbers that
25 we -- that resulted from that calculation.

1 Q Let's unpack that a little bit. So you started with a --
2 the Christie's data; is that right?

3 A Correct.

4 Q And the Christie's data reflected a sampling of the
5 actual DIA collection; is that right?

6 A Correct.

7 Q Okay. I think you testified you also received a listing
8 of the remaining 57,000 objects from the DIA.

9 A Correct.

10 Q Were you able to break down each group into corresponding
11 sectors?

12 A Yes.

13 Q Okay. So then what did you do? Let's assume you had one
14 sector as an example, as a hypothetical, in a Christie's
15 sampling. You had a corresponding sector in the DIA. What
16 did you do within that sector of the Christie's data before
17 applying it to the DIA sector?

18 A So let's say the Christie's American sector had ten works
19 of art in it, and it would have two works of art below a
20 thousand dollars. It would have one work of art between
21 1,000 and 5,000. It would have three works of art between
22 5,000 and 50,000. It would have then the balance maybe
23 between 500 and 750,000. We would then take that same
24 percentage and apply it to the breakdown of the American
25 sector in the DIA collection. So if you had ten items in the

1 American sector in the Christie's data, you might have a
2 hundred items in the DIA data, so then you would apply the
3 values in those different lot bands to -- from Christie's to
4 the same -- to the number of objects in the --
5 proportionately in the Detroit collection.

6 Q So were you able by these value bands in the Christie's
7 data to determine where in the DIA data -- the number of
8 objects that would be within those value bands?

9 A Yes; correct.

10 Q And how did you determine the multiplier that would be
11 used to those DIA value bands?

12 A They were taken from the estimates for those bands in the
13 original Christie's data, and then they were projected onto
14 the same bands in the DIA data.

15 Q Did you account in your consideration of the Christie's
16 data for one sector as the example we've described? Did you
17 account for the fact that Christie's found so many objects as
18 to which there was no commercial value?

19 A Yes. They were in the zero to 1,000 band.

20 Q Okay. And so it was that same arithmetic used in terms
21 of projecting --

22 A Correct.

23 Q -- onto the DIA collection?

24 A Correct.

25 Q I think you said the value bands in the Christie's

1 sampling -- I didn't hear you say there were any value bands
2 above \$750,000.

3 A There were not, no, because --

4 Q Why was that?

5 A Because that was accounted for in the hands-on appraisal.
6 That would have been double counting.

7 Q In what sense? Can you explain that?

8 A Well, we had -- Christie's had -- we had separated the
9 Christie's appraisal above 750, and we had also done our own
10 analysis of 750, so it would have distorted the numbers if we
11 had included any of those in those calculations because we
12 were trying to assign the value to everything in the DIA
13 collection below 750, so we needed to use numbers below 750.

14 Q To your satisfaction in terms of the remaining 57,000
15 pieces, had you already accounted for the high value items?

16 A Yes.

17 Q So then why would it be appropriate to include high value
18 items in the multiplier that you were going to use to those
19 sections?

20 A Well, it wouldn't have been because it would have
21 distorted the numbers, and at such a large multiple of 57,000
22 objects, it could have a hugely distorting effect on the
23 valuation.

24 Q Did you consider any other -- well, let me ask you this.
25 Are you comfortable with the results that you reached in

1 connection with this analysis?

2 A Yes, we are, because we felt that the City of Detroit
3 property valued by Christie's was not only logical but also
4 if it had a bias would have a bias on the high side because
5 the City of Detroit property was most likely purchased
6 strategically whereas the rest of the collection that had
7 been given with gifts and had been acquired -- I wouldn't say
8 randomly but in an ad hoc basis by curators, some of it for
9 educational purposes and scholarship, probably would have an
10 even higher number of low value items than City of Detroit
11 property would, so we felt that this was a fair -- the
12 fairest representation of the collection.

13 Q Did you consider any other possible approaches in terms
14 of valuing these 57,000 items?

15 A We did. We did another cut just using a straight
16 unweighted average from all of the Christie's property below
17 750,000, and it resulted in a radically lower number, which
18 made us comfortable with this number that this was probably
19 the right number to work with.

20 Q What was the radically lower number that your other
21 approach came in with?

22 A It came in with a number of 90 million to 200 million.

23 Q Instead of the 650 million to almost --

24 A Correct.

25 Q -- 1.3 billion --

1 A Correct; correct.

2 Q -- it came in at what number?

3 A 90 million to a hundred -- to 200 million.

4 Q And you chose not to use that approach?

5 A Yes, because we felt using the weighted average approach
6 really was a more balanced approach and was probably more
7 reflective of what's in the collection.

8 Q Did you consider using Christie's or Sotheby's sales data
9 as an alternative approach for this?

10 A We did. We looked at it for about an hour and dismissed
11 it fairly quickly because there was -- there were two flaws
12 with it. One was that there was no logical connection
13 between what is sold at Sotheby's and Christie's in any one
14 year and what is actually in the DIA collection. And the
15 other was that you can't break out the high value items from
16 the Sotheby's and Christie's data, so if you're using the
17 average value of the Sotheby's and Christie's data, you're
18 actually creating an aggressive or excessively high average
19 because you're including in that hundred million dollar sales
20 and ten million dollar sales and all those things above
21 750,000, which we're trying to exclude.

22 Q Okay. Does City Exhibit 666 -- does this contain your
23 conclusions as to the indicative value of the total DIA
24 collection?

25 A Yes, it does.

1 Q And you've got a low estimate and a high estimate. Do
2 you see that?

3 A Yes.

4 Q And then the third column says mid-estimate. Is the mid-
5 estimate a separate analysis, or is this some sort of
6 arithmetic calculation?

7 A It's just an arithmetic calculations, the midpoint
8 between the low and the high.

9 Q Okay. Do these baseline valuations that are in City
10 Exhibit 666, do they assume anything about sale conditions?

11 A No. They're the -- they are the same as the Christie's
12 evaluation. They are taking a value at a point in time in
13 isolation of anything that's going on in the marketplace and
14 any sales factors or volume discounts or any factors that
15 would affect the marketplace.

16 Q Is there anything about your analysis or the conclusions
17 that are depicted in City 666 that speak to whether the city
18 could actually sell these items?

19 A No. It does not consider clarity of title or
20 restrictions by donors or anything like that. None of that
21 is taken into account here.

22 Q Okay.

23 MR. IRWIN: Your Honor, at this time, we would offer
24 City Exhibit 666 for demonstrative purposes.

25 MR. SOTO: No objection as a demonstrative.

1 THE COURT: May I call your method the weighted
2 average method?

3 THE WITNESS: Sure.

4 THE COURT: Does it have any other name?

5 THE WITNESS: I don't have another name for it.

6 THE COURT: Is this a method that is generally used
7 and relied upon in the expertise of evaluating museum or
8 privately held collections?

9 THE WITNESS: Such an evaluation has never been done
10 before of this magnitude, and --

11 THE COURT: In that event, counsel, you need to
12 establish its reliability by some other means.

13 MR. IRWIN: Your Honor, are you speaking directly to
14 the 57,000 --

15 THE COURT: Yes.

16 MR. IRWIN: -- piece component of it?

17 THE COURT: Yes.

18 MR. IRWIN: Okay.

19 THE COURT: The rest of it is just Christie's
20 rejiggered; right?

21 MR. IRWIN: Well, in Artvest's calculations.
22 There's a Christie's component to it and an Artvest
23 independent appraisal component.

24 THE COURT: Okay. Fair enough, but, yeah, it's the
25 remaining DIA 57,181 that has been the subject of this

1 weighted average approach, right, sir?

2 THE WITNESS: Yes.

3 MR. IRWIN: May I offer the -- may I offer the
4 exhibit for demonstrative purposes for those other aspects of
5 it, your Honor?

6 THE COURT: Yes.

7 MR. IRWIN: Okay.

8 THE COURT: What was the number again?

9 MR. IRWIN: 666.

10 THE COURT: All right. So except for the line that
11 says "remaining DIA," the document will be admitted for
12 demonstrative purposes.

13 (City Exhibit 666 received at 4:37 p.m.)

14 BY MR. IRWIN:

15 Q Mr. Plummer, I do want to ask you some more questions
16 about this, but let me ask you something else first. You've
17 got low estimates and high estimates on this chart. Do you
18 see that?

19 A Yes.

20 Q We're talking about the mid-estimate.

21 A Yes.

22 Q Do you see that? And that's an arithmetic calculation?

23 A Correct.

24 Q Is that what you said? Okay. Did you reach an opinion
25 or did you have occasion to reach an opinion as to whether

1 the high estimate in connection with this exercise was more
2 or less likely?

3 A Because of the conditions in the marketplace that we
4 discussed earlier with most of the categories in which the
5 DIA's collection is held, meaning everything other than
6 contemporary art, that it was highly unlikely that the high
7 estimate would be hit because that pretty much assumes that
8 every work of art has to hit the high estimate, whereas most
9 of the collection of the DIA is in sectors other than post-
10 war and contemporary where property is selling at or around
11 the low estimate.

12 Q Okay. We talked about some of the -- the performance of
13 some of these sectors earlier, I believe.

14 A Right.

15 Q Do you recall that?

16 MR. IRWIN: Could we publish, please, City Exhibit
17 649?

18 THE COURT: Before we do that, leave this one up,
19 please. Am I correct in interpreting this chart that the
20 bottom line where it says "Total DIA Collection" includes the
21 line that says "Remaining DIA"?

22 THE WITNESS: Correct.

23 THE COURT: Then I can't admit that as a
24 demonstrative either.

25 MR. IRWIN: We have admitted, I think, the first

1 two --

2 THE COURT: First two.

3 MR. IRWIN: What's highlighted in yellow.

4 THE COURT: Yeah, yeah. The first two lines that
5 are highlighted in yellow, I'll admit those as
6 demonstratives.

7 MR. IRWIN: Okay.

8 BY MR. IRWIN:

9 Q Mr. Plummer, have you had a chance -- I think we were
10 talking about whether you had a chance to consider as to
11 whether the high estimate in your valuation as a concept
12 is --

13 A Right.

14 Q -- likely to be realized in this case.

15 A Right.

16 Q Okay. Could we look at Exhibit -- City Exhibit 649? Do
17 you have that in front of you, sir?

18 A Yes, I do.

19 Q And what is it that is purported -- what is purported to
20 be depicted in 649?

21 A This shows -- the bar is the hammer price, and the red
22 dot is the low estimate, and the dark dot is the high
23 estimate. And the chart on the left -- the bar on the left
24 is impressionist and modern art, and the chart on the right
25 is post-war and contemporary. And this is a pretty

1 consistent trend now. This happened in May 2013 and happened
2 as recently as 2014, the most recent sales, where the post-
3 war and contemporary sales are far exceeding their high
4 estimates and the impressionist and modern sales are either
5 just meeting their low estimates or just barely exceeding
6 them.

7 Q Okay. And I think you said this chart is -- this is
8 Christie's data for May 2013 evening sales.

9 A Correct.

10 Q Do you see that?

11 A Correct.

12 Q What is the significance of May 2013? Did you pick it
13 for a particular reason?

14 A Yes. It is an ongoing trend. It happened back then, and
15 it has happened most recently in May 2014. Both sales at
16 Sotheby -- of impressionist and modern art and post-war and
17 contemporary art were good quality art that was fresh to the
18 market. They both had strong attributes, but the one market
19 is -- the post-war and contemporary is very aggressive, and
20 the impressionist and modern market has become very
21 selective.

22 Q And I was focusing more on the date. Is there a reason
23 for May of 2013?

24 A Oh, yeah. The evening sales at Sotheby's and Christie's,
25 which are the bellwether of the industry, are held every year

1 in the first two weeks of May and the first two weeks of
2 November, and those are the -- those are the biggest sales of
3 the year and the ones that market watchers observe to see how
4 the industry is faring.

5 Q And so the chart on the right, this is post-war and
6 contemporary on the right. That's something we've talked
7 about before; is that right?

8 A Um-hmm, yes.

9 Q And what is depicted on the left?

10 A On the left is impressionist and modern art.

11 Q And what conclusions do you draw about the performance of
12 impressionist and modern at these evening sales in May 2013?

13 A That most of the art that is being sold there is selling
14 at close to the low estimate.

15 Q Okay. Does the -- have you done an investigation as to
16 whether other sectors performed in May 2013 more like
17 impressionist and modern or post-war and contemporary?

18 A Most other sectors are performing in the same fashion as
19 impressionist and modern art.

20 Q And how does that relate to your opinion as to whether
21 the sale of the -- a potential sale of the DIA collection
22 would hit low or high estimates?

23 A Well, the percentages of the collection in the DIA are
24 mostly in noncontemporary areas, so that would give me an
25 expectation that that property would likely sell at or around

1 the low estimate and not near the high estimate. Perhaps the
2 post-war and contemporary sector would, but most of the other
3 art would not.

4 Q Okay. And this was in May of 2013?

5 A Right.

6 Q Okay. Can we -- this is not in your binder but I would
7 like to put on the screens for you.

8 MR. IRWIN: Can we please publish City Exhibit
9 Number 460? Yeah. I'm reminded I should offer, your Honor,
10 City Demonstrative Exhibit 649.

11 THE COURT: Which one was that, sir?

12 MR. IRWIN: It was the chart that we were just
13 looking at, the May 2013 evening sales.

14 THE COURT: All right. Please put it back up.
15 Thank you. Sir, can you tell me again what the bar
16 represents?

17 THE WITNESS: Sure. The bar is actually the sale
18 results, the hammer price, what was referred to as the hammer
19 price without buyer's premium, and -- in each case, and then
20 the red dot is the low estimate, and the dark dot is the high
21 estimate.

22 THE COURT: So these are aggregates for all of the
23 sales?

24 THE WITNESS: These are aggregates for the sales at
25 Christie's New York on those days, evening sales.

1 THE COURT: Thank you. Any objections?

2 MR. SOTO: Not as a demonstrative.

3 THE COURT: All right. It is admitted.

4 (City Exhibit 649 received at 4:44 p.m.)

5 MR. IRWIN: All right. Can we pull up City Exhibit
6 460, please? And then I'd like to -- and then I think we
7 need to go to page 9 of this document.

8 BY MR. IRWIN:

9 Q Mr. Plummer, do you have this chart in front of you?

10 A I do, yes.

11 Q Does this chart come from your report?

12 A Yes, it does.

13 Q Okay. What does Chart 6 in your report purport to
14 represent?

15 A The same thing in comparison of auction results versus
16 hammer price auction results for May sales in 2014. The bar
17 represents the aggregate results for the hammer price and
18 then the bottom dot the low estimate and the higher dot the
19 high estimate.

20 Q Okay. So this is a -- is this a similar chart from what
21 we just saw --

22 A Yes; correct.

23 Q -- just repeated in 2014?

24 A Correct.

25 Q And what do you -- what conclusions do you draw about the

1 performance of the post-war and contemporary sector?

2 A Again, that it is exceeding its estimates and, as you
3 can -- as you might compare it to the other one, that it's
4 actually growing, so these sales are growing each year, and
5 that the impressionist and modern sales are performing around
6 their low estimate, below or slightly above.

7 Q Now, this was -- this particular chart was included in
8 your report when it was prepared; is that right?

9 A Correct.

10 Q Have you had any reason to investigate further the data
11 that informed the bar graph on the left side, the
12 impressionist and modern?

13 A Yes. After we submitted the report, we issued a
14 correction because there was some data missing, some sales
15 results missing for the impressionist and modern sale, but it
16 didn't materially change the impact. The number was actually
17 250 million, so it was the hammer price, so it was slightly
18 above the low estimate rather than slightly below, but it
19 still was far off of the high estimate.

20 Q So for 2014, you would need to correct the bar on the
21 left, and you would have to raise it and bring it, what, just
22 inside that 230 --

23 A Correct.

24 Q -- \$230 million figure?

25 A Correct, but very far away from the high estimate of 481

1 million.

2 Q Okay. And how, if at all, does this chart, the data
3 reflected in this chart, relate to your opinion as to whether
4 or not the DIA would achieve high estimates or low estimates?

5 A Well, again, as the preponderance of the collection is in
6 sectors like impressionist and modern art that are performing
7 around their low estimates, that -- we feel that using high
8 estimates in the evaluation would not be the correct way to
9 go.

10 Q Are other market sectors performing more like
11 impressionist and modern or post-war and contemporary in
12 terms of evening sales?

13 A All sectors are performing other than post-war and
14 contemporary like impressionist and modern.

15 Q Including with regard to whether or not they're hitting
16 low estimates or high estimates at evening auction sales?

17 A They're hitting either low estimates or in between the
18 low and the highs --

19 Q Okay.

20 A -- or below the lows.

21 Q Have you had a chance to consider the profile of the art
22 collection at the DIA and analyze it by market sector?

23 A Yes, I have.

24 Q Okay.

25 MR. IRWIN: Could we please put up City Exhibit 664,

1 please?

2 BY MR. IRWIN:

3 Q Do you have City Exhibit 664 in front of you?

4 A I do.

5 Q What does City Exhibit 664 purport to represent?

6 A It purports to show the value of the DIA collection by
7 category.

8 Q Where did you get the -- well, first of all, did you
9 prepare this chart?

10 A Yes.

11 Q And where did you get the data to create the chart?

12 A This was data combined from Christie's and from the DIA
13 to come up with a master data file that -- with a value on it
14 that segregated these by sector.

15 Q I know it's hard to read. It's certainly hard for me to
16 read from here, but where are the -- where are the -- where's
17 the DIA collection concentrated?

18 A It's concentrated with 28 percent in European paintings
19 or what we'd refer to in the auction world as old masters,
20 19th century, into European modern art to 1950, which would
21 actually also include impressionist and post-impressionist,
22 and that's 24 percent. American art before 1950 is 15
23 percent, and then the area of the market that's quite hot is
24 16 -- is contemporary art, which is 16 percent.

25 Q And what about the -- what is in the balance of the DIA

1 collection?

2 A The balance of the DIA collection is more the decorative
3 arts, and the only other area that might fit -- have a
4 characteristic similar to contemporary art would be Asian
5 art, which is only three percent of the collection, but that
6 collection is not necessarily of the caliber that collectors
7 are looking for right now, so I'm not sure I would propose
8 that it have the same aspects of contemporary art.

9 Q So how much of the profile of the DIA collection, if this
10 were contemplated for sale in a commercial marketplace, how
11 much of it is in a part of the art market that is performing
12 strongly right now?

13 A Only 16 percent.

14 Q And which portion is that?

15 A That's the contemporary art after 1950.

16 Q The purple section of the --

17 A Right.

18 Q -- pie chart?

19 MR. IRWIN: Your Honor, at this point, I would move
20 City Exhibit 664 into evidence as a demonstrative.

21 MR. SOTO: No objection as a demonstrative.

22 THE COURT: It is admitted.

23 (City Exhibit 664 received at 4:50 p.m.)

24 BY MR. IRWIN:

25 Q Have you had occasion to track the performance of these

1 particular market sectors, the market sectors that correspond
2 to the DIA profile over time?

3 A Yes, I have.

4 Q Okay. And do you have any visuals to support that?

5 A Yes, I do.

6 Q Okay.

7 MR. IRWIN: Okay. Can we please publish City
8 Exhibit 661?

9 BY MR. IRWIN:

10 Q You have that, City 661 --

11 A Yeah.

12 Q -- in front of you? What is City Exhibit 661?

13 A This is the Mei Moses Art Index, and it is tracking
14 performances of four sectors from 2003 through 2013, a ten-
15 year period, and it shows you -- just to clarify, the blue
16 line is the American sector before 1950. The dotted green
17 line is impressionist and modern sector. The black line is
18 old masters and 19th century, and the dotted gold line --
19 orange line is post-war and contemporary. And as you can
20 see, they all suffered in the downturn of 2008 to 2009,
21 though, as we discussed earlier, post-war and contemporary
22 suffered the most, but since that downturn, they have
23 recovered at different paces. Post-war and contemporary has
24 not only regained the old ground but has gone far beyond it.
25 Impressionist and modern declined less and has regained the

1 ground but has stagnated or stabilized. And old masters and
2 American paintings have not yet recovered fully from the
3 downturn in 2008 and have actually shown some decline since
4 2012.

5 Q Do these four lines -- do the four lines that are
6 depicted in City Exhibit 661, do they bear any relation to
7 the four principal sectors that we saw on the pie chart for
8 the DIA profile?

9 A Yes. This is where a high preponderance of the DIA
10 collection is held in these sectors.

11 Q And when you say "in these sectors," do you mean in all
12 four of these sectors?

13 A Yes.

14 Q Okay. Among those four sectors, how much is post-war and
15 contemporary, which is the dotted red line?

16 A I believe it was 16 percent, if I remember correctly.

17 Q And how much of the DIA collection is represented by the
18 other three lines, by the blue line, the black line, and the
19 dotted green line?

20 A I can't remember off the top of my head, but it's maybe
21 80 percent or 60-some percent. It's a very significant
22 number.

23 Q And so for -- let's take a look at one of these other
24 lines. The American before 1950, do you see the blue line on
25 the chart?

1 A Yes.

2 Q Okay. What conclusions have you drawn, if any, about the
3 trend line of American art before 1950?

4 A Well, that market is actually suffering worse than all of
5 them because its collector base is dying off, and young
6 collectors are moving into post-war and contemporary. Old
7 masters has a similar sort of problem but is a little less
8 extreme because it's collected internationally. Excuse me.
9 And impressionist and modern is not quite as severely hit as
10 the other two.

11 Q By the way, is this a chart that you prepared personally?

12 A No. It was prepared by Mei Moses Art Indices.

13 Q And who is -- who or what is Mei Moses Art Indices?

14 A Michael Moses and Jianping Mei have this index, which is
15 now widely used by finance people and others to track the art
16 market. It's a repeat sales index.

17 Q And did you -- where did you get the -- did they produce
18 a chart just like this, or did you get the data from them?

19 A No, no. They produced the chart.

20 Q And I just want to be clear, Mr. Plummer. When you talk
21 about the valuation, do you mean from a commercial
22 perspective or from other perspectives?

23 A I mean from a commercial perspective.

24 Q Okay.

25 MR. IRWIN: Your Honor, I'm about to move into a

1 large section. I'd be very happy to resume tomorrow morning.

2 THE COURT: Okay.

3 MR. IRWIN: Yes. Actually, before we -- thank you.
4 I would like to move in City Exhibit 660 -- well, 661 as a
5 demonstrative.

6 THE COURT: Any objections?

7 MR. SOTO: No objection as a demonstrative.

8 THE COURT: Okay. Any further business before we
9 adjourn? All right.

10 MR. IRWIN: We'd actually -- I'm sorry. We'd like
11 to move this in as a market report for its truth. This one
12 is not prepared by the witness. This is a market report.

13 MR. SOTO: As a demonstrative, fine, but otherwise
14 it's hearsay. It's a market report that I'm not familiar
15 with and that they haven't backed up with --

16 THE COURT: Well, the witness testified as to what
17 it is.

18 MR. SOTO: Yeah, and that he relied on it, but it
19 had nothing to do with the substantive nature of it.

20 THE COURT: Well, but he testified that it's a
21 market report that the market relies on. Didn't you say
22 that, sir?

23 THE WITNESS: I did.

24 THE COURT: All right. The objection is overruled,
25 and the document is admitted for all purposes.

1 (City Exhibit 661 received at 4:55 p.m.)

2 THE COURT: All right. So we'll be in recess until
3 tomorrow morning at 8:30.

4 THE CLERK: All rise. Court is adjourned.

5 (Proceedings concluded at 4:55 p.m.)

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I certify that the foregoing is a correct transcript from the sound recording of the proceedings in the above-entitled matter.

/s/ Lois Garrett

September 23, 2014

Lois Garrett